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# FOREIGN INVESTMENT AND INTERNATIONAL ROUTE SALES

## HEARING

BEFORE THE

## SUBCOMMITTEE ON AVIATION

OF THE

## COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

ON

FOREIGN INVESTMENT AND INTERNATIONAL ROUTE SALES

FEBRUARY 19, 1991

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# FOREIGN INVESTMENT AND INTERNATIONAL ROUTE SALES

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## TUESDAY, FEBRUARY 19, 1991

U.S. SENATE,
SUBCOMMITTEE ON AVIATION,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
*Washington, DC.*

The subcommittee met, pursuant to notice, at 10:00 a.m. in room SR-253, Russell Senate Office Building, Hon. Wendell H. Ford (chairman of the subcommittee), presiding.

Staff members assigned to this hearing: Carol Carmody, professional staff member; Sam Whitehorn, staff counsel; Alan Maness, minority staff counsel; and Bill Hughes, minority professional staff member.

## OPENING STATEMENT BY SENATOR FORD

Senator FORD. Good morning, ladies and gentlemen. I am pleased to be presiding at this hearing this morning because I believe the subjects are vital to the future of the U.S. aviation industry. We have spent a lot of time in the Aviation Subcommittee examining the state of the industry.

Last session we held numerous hearings on the subjects of competition and consolidation in the industry. We have looked into certain practices of the carriers which may inhibit competition. We have talked about the role of the Department of Transportation in insuring a healthy, competitive environment. We have worried about the shrinking number of carriers, the barriers to new entry, hub domination and fares.

I want the record to reflect that I like Secretary Skinner. I just disagree with him. In the last month the Secretary of Transportation has taken actions which could do more to speed consolidation, stifle competition and restructure the domestic airline industry than any action since the former Secretary approved every line merger she saw.

The Secretary has recently announced a new policy toward foreign investment in U.S. air carriers. This is a subject he and I have visited about before. A year and one-half ago he agreed that if foreign airline owned large amounts of equity in a carrier, it might constitute control. Now he does not seem to think that is a problem.

We are told we must create a favorable environment for foreign investment in our air carriers. I am afraid we are trying to solve the financial troubles of the domestic airline industry today by opening the door for foreign control tomorrow. I have to ask myself why a non-U.S. airline would want to put money in a U.S.

carrier if not in hopes of exercising some control over that carrier and tapping into our valuable domestic market.

What do we get in return? Will our carriers and their employees be better off? Will we wake up in 5 years and find our advantage in aviation has been lost to other countries who own and control most of our airlines?

A number of struggling carriers are choosing to sell off valuable assets such as international routes. Naturally, there are other carriers who seek to buy these. A couple of these transactions have been approved already by the Department of Transportation, and others are pending.

The Secretary said he wants to find ways to streamline this process so that the free market may work more quickly. It took him 3 days to agree to petition by Northwest. That is about as streamlined as you can get.

I always worry when the Secretary of Transportation begins to talk about market solutions. That seems to mean solutions that do not involve the Congress or the general public. These routes are valuable assets. As I told the Secretary in a recent letter, I think the review should be thorough. The effect of such transfers on a domestic airline industry must be weighed.

When we passed the Aviation Safety and Capacity Expansion Act of 1990, we asked the Secretary to certify to us by report how the route transfer affects the viability of the carriers involved, the competition in the domestic industry and the U.S. trade position. We have not received a report. We got a letter with the DOT final order attached, and I do not believe that meets the requirements of the legislation.

I question whether Secretary Skinner should be making decisions which have enormous implications without any consultation with or deliberation by the Congress. His decisions on foreign investment and route transfers could restructure the entire remaining U.S. airline industry.

Furthermore, the Secretary has said he will consider everything on a case-by-case basis. That means there is no policy, no policy to measure against or to argue with. The policy is whatever the Secretary says it is. The statute is there, but his interpretations change from year to year and almost month to month.

These are matters for the Congress. These are issues for deliberation by the committee, and I hope today's hearings will be a start in that direction. Senator McCain.

## OPENING STATEMENT BY SENATOR McCAIN

Senator MCCAIN. Thank you very much, Mr. Chairman.

I, like you, not only like the Secretary, I admire him and respect him and appreciate the outstanding job he has done. I think that he has put more dynamism and activism into his job than anyone in recent history. However, we are at significant disagreement at this time.

I would first like to express my appreciation to you for holding this hearing, Mr. Chairman. You clearly recognize the importance of this committee's oversight of developments in the aviation industry and the need to maintain competition.

This hearing on the role of recent Department of Transportation decisions concerning international route sales and foreign ownership follows up on a series of hearings on competition issues during the past two Congresses. I think we could make an argument, Mr. Chairman, that you and I have spent more time on that issue alone than all the others put together, and we do not come to this hearing devoid of knowledge or experience on these issues.

Given $2 billion in industrywide losses in 1990 and the number of airlines in bankruptcy or default, what I see today troubles me and the American people

greatly. We cannot wait for the industry shakeout to end before we act. I believe we must take action to preserve a competitive domestic airline industry if that is still possible.

I welcome Secretary Skinner before us. Secretary Skinner, you have previously said that the current industry consolidation is an inevitable result of the market forces unleashed by the Airline Deregulation Act of 1978. Given this view, it is instructive to look back at what was promised when Congress enacted deregulation.

The conference report accompanying the act was quite clear in its declaration of purpose. It said, and I quote, "the prevention of unfair, deceptive, predatory or anticompetitive practices in air transportation and the avoidance of unreasonable industry concentration, excessive market domination and monopoly power."

In fact, in testimony before this committee in 1977, the Department of Justice testified that: "this is not a business in which there are enormous economies of scale. It is a business where someone who can operate on a lower cost basis can do better. I just do not see this as a situation in which we are going to get more concentration."

Given this promise of deregulation, what is the reality? The reality is that the promise has not been fulfilled. Today the airline industry is not, as Jim Miller told this committee in 1977, one in which the "ease of entry in deregulated markets would act to 'police' the market and thus prevent any abuses of monopoly power." The current hands-off approach is not healthy, nor does it foster competition. A few recent examples make this absolutely clear.

The day after Eastern stopped flying from Chicago to Miami, United Airlines raised its lowest fare on the route from $198 to $379. The Justice Department found that United's attempted purchase of Eastern slots at Washington National Airport was anticompetitive and violated antitrust laws.

The General Accounting Office recently reported that the lack of effective competition in the CRS industry—computer reservation systems—allows American and United each to receive over $300 million per year in excess of the costs of the service provided including a reasonable profit. Today at 18 major airports, a single airline controls more then 60 percent of the passengers. Prior to deregulation, no airport experienced this type of dominance.

Given this sad litany, we must ask, do we need to take additional action now to fulfill the promises of deregulation?

I look forward to the testimony today, Mr. Chairman. I am anxious to hear the evidence of how additional international route sales and foreign investment will aid competition. On its face, the evidence to date of route sales from financially troubled airlines to large, wealthy airlines only reinforces the fact that the big get bigger and the poor get poorer.

Mr. Chairman, I wonder if it is too late. I wonder if we are already seeing a consolidation of this industry which will cause American consumers, the Americans whom we are eagerly seeking to get back on airliners and travel, to be penalized by what has transpired in the past few months. It is of great concern to me and this committee, and, frankly, Mr. Chairman, I am very disturbed and think that we should shape some kind of legislative action if it is not too late.

I thank you, Mr. Chairman.

Senator FORD. Thank you, Senator McCain.

We are pleased to have the Chairman of the full committee with us today, Senator Hollings. If you have a statement you would like to make, we would be pleased for you to do so at this time.

## OPENING STATEMENT BY THE CHAIRMAN

The CHAIRMAN. Thank you very much, Mr. Chairman.

Secretary Skinner, we want to welcome you to our subcommittee hearings. The full committee is vitally interested in this as Senator Ford, our chairman, will tell you.

We were ready to have hearings in December when we saw some of the activity over in the Department of Transportation. You are a mover and a fast mover. And I like somebody who moves. Of course, that moves us.

The question is, in the long range, Mr. Secretary, as to whether or not the public convenience and necessity is being served on the one hand and the national economic security is being protected on the other hand with respect to the approval of these routes that have carried the approval of the Acquisitions. Under the law, of course, it should be owned by a majority with U.S. citizenship.

We look at the KLM acquisition of Northwest. We look at the sale of Pan Am's international routes, all established on the basis of convenience and necessity, but then sold as a property right of the airline itself.

I know parochially down in our section of the country where Eastern was predominant, all of those gates and carrying rights and everything else were premised on the public need. And now they are bought in the so-called free market or deregulated market at $26 million, not to serve that market at all, but to serve an entirely different Midwest market. And all of that public need then is left wanting.

So we finally bring in the end results of so-called deregulations and we see the chaotic situation where we are going to have work together and make absolutely certain that the public convenience and necessity is being served, that monopolistic practices do not develop.

And more particularly, internationally when we talk of free trade, the governments control our competitor there. They are fundamental entities in the international competition. We cannot treat these as private entities any longer in that kind of competition.

I do not see how we are going to survive and really get into that European market and allow a competitive market here, domestically, unless we set down some hard and fast rules to protect the local investments and services that we have in the air carrier service.

It is complicated, but it is fundamental. I am glad that you are all moving. It moves us. I think we can move fast enough to catch you.

Thank you very much, Mr. Chairman.

Senator FORD. Thank you. Senator Exon?

## OPENING STATEMENT BY SENATOR EXON

Senator EXON. Mr. Chairman, thank you very much. I appreciate your calling this meeting.

Mr. Secretary, welcome to you and to other members of the panel. I am very much interested in what you about to testify to and in the follow-on hearings.

It has been said here this morning by the Chairman, I believe in his opening remarks, that this is a tremendously important hearing because I believe it is the beginning of a look at the whole overhaul of our airline transportation system.

It is obvious to me and to many of us who live outside of the cities that are generally described as the heaviest-used airports that deregulation, by and large, has not been good and will not be good over the long haul for the vast majority of Americans.

I am concerned very much about the whole slot problem that you and I have discussed on many, many occasions. I must say that I appreciate the fact that in many instances I think you agree completely with those of us sitting up at this table on the whole slot matter. But I know that it is a very difficult decision.

The facts of the matter are, I suspect, that the whole matter of, quote, "ownership of slots," whatever that means, may be one of the financial bulwarks on the financial sheets of many of the airlines today.

I am also very much concerned, Mr. Secretary, about how far we are going to further selling-out of American interest to foreign interest now in our vital transportation links, such as our airlines.

I have no definite prejudgments on this whole matter. I hope and I think that something is likely to be worked out. And if we can depend upon you to at least listen to us, as you have in the past, hopefully something can be resolved on this.

In closing, Mr. Chairman, thank you for calling this very, very important meeting. And I, for one, am looking very much forward to the testimony. Then I will have some questions.

Senator FORD. Thank you very much, Senator Exon. Senator Bryan?

## OPENING STATEMENT BY SENATOR BRYAN

Senator BRYAN. Thank you very much, Mr. Chairman. Let me complement you for holding this hearing and to welcome the Secretary here this morning. It is always nice to see him and to express a couple of concerns which I have which I hope we can develop further this morning.

Specifically, with respect to the foreign investment in American carriers it strikes me that that involves a reciprocity issue that I hope we can discuss this morning.

That is, what is the access that we have in terms of equity participation in foreign carriers and does this indirectly emasculate or circumvent the bilateral negotiation process, country to country, which your department is responsible for, Mr. Secretary?

I think there are some national security issues that we will want to explore which have been brought into focus in light of our current involvement in the Gulf and the civilian aviation component of that logistical support effort.

Finally, I think we will want to explore what the implications are of foreign investment in terms of route diversion for American carriers that are subject to this foreign penetration and the potential revenue hollowing out that might be as a consequence of that.

Those are some questions, Mr. Chairman, that I hope to be able to ask.

Mr. Chairman, I commend you for holding this hearing on foreign investment in United States airline carriers. We all recognize that the airline industry plays an increasingly important role in today's economy.

In my home state of Nevada, the airlines play a particularly significant role in support of our tourism industry. Safe, reliable and fairly priced airline service is critical not only to Nevada passengers, but also to the millions of Americans and foreign tourists who use the airlines to visit Nevada. More than 50 percent of the visitors to our state travel by air.

Recent reports from the Department of Commerce indicate a 40 percent loss in foreign tourist travel to the United States. I am deeply concerned about the impact this decline will have on the airlines and the tourism industry. Rising fuel prices and fear of terrorism have already caused reverberations throughout this important sector of our economy. The financial viability of the airlines is critical to our transportation and travel systems. I am particularly pleased to see Secretary Skinner here today to testify on his recent decisions to expand foreign investment

opportunities. I understand he believes that an infusion of foreign capital may help our financially troubled airline industry.

We need to exercise caution and study all of the consequences before we allow foreign investment in our carriers of up to forty-nine percent. Globalization of the airlines is a two-way street and we cannot continue to permit foreign ownership of American enterprises, without reciprocity.

Mr. Chairman, I look forward to the testimony of the representatives of our airlines and the Airline Pilots Association about this change in current policy and their assessment of its impact on the future of the airline industry.

Senator FORD. Senator Danforth?

## OPENING STATEMENT BY SENATOR DANFORTH

Senator DANFORTH. Thank you very much, Mr. Chairman.

I suppose that the job of anybody in the Senate, first and foremost, is to represent his constituents.

I have spoken with Secretary Skinner on a number of occasions, so he knows what my concerns are. They have to do with the viability of TWA. TWA has been a very major presence in my State; 82 percent of all the passengers in St. Louis are TWA passengers.

We have thousands of employees who are dependent on TWA and who are dependent on Lambert Field in St. Louis. We have the TWA overhaul base in Kansas City. TWA is on the ropes.

The Secretary has approved of the sale of the route from Chicago to London by TWA. I have taken the position that that is a disastrous decision, that Carl Icahn is simply selling off his airline in pieces. It is going to be left with an unsustainable domestic core. And I would like to know where we are going.

St. Louis, of course, is one city. It happens to be very important to me. But there are other cities that are similarly situated.

We passed airline deregulation back in 1978 and I voted for it. It seemed to me as though it was good economic philosophy, the idea that Government should not be controlling major industries. But I must say that that was a very bad decision on my part.

Deregulation has backfired in this country. It has left major cities and industries and human beings dependent upon the likes of Carl Icahn, dependent on how he is going to service his debt and what pieces are going to be sold off and what cities are we going to close down tomorrow.

People have said that TWA might have a few days or weeks to go. I do not know how many days or weeks it has. But I know that when it falls, when it crashes, there are going to be a lot of people who are going to be hurt by the crash.

We, Senator McCain and others, last year proposed some legislation to get at some of the problems based on various reports by the General Accounting Office on the problems with the airline industry.

The Administration, of course, opposed the legislation. The legislation ended up going nowhere.

So I am concerned that the position is just let it fall. I mean, is that not supposedly the free enterprise system? Just let it collapse. If somebody is hurt, too bad.

But Mr. Chairman, it is not a competitive situation as it was supposed to be after deregulation if we have one airline that has 82 percent of the passengers at an airport. And it is not a competitive situation if we are moving toward three viable airlines in the United States.

Maybe the Secretary has a good point. Maybe we should start opening up the ownership of the U.S. airlines to airlines in other countries. I do not know where the capital in going to come from.

Necessity is the mother of invention. It strikes me as sort of a weird situation if we are hoping that the British or the Taiwanese or the Koreans come up with the scratch to bail us out of this miserable situation.

But what struck me as a totally bizarre situation only a few weeks ago is something that I might be willing to consider.

What I want to find out from the Secretary is where we are going with the U.S. airline industry. What is going to happen to TWA? What is going to happen to the people who have been employed by it for decades? What is going to happen to the city of St. Louis and the surrounding communities?

What is going to happen to the people in Kansas City at the overhaul base? What is going to happen to all those people?

Are we just going to handle little problems on a sort of ad hoc base? Well, you want to sell, Mr. Icahn? You want to sell off your route to London? Why, of course. Sure. Why not.

Putting it mildly, Mr. Chairman, I am interested in this hearing.

Senator FORD. If this is mild, I would hate to see you mad.

## OPENING STATEMENT BY SENATOR BENTSEN

Senator BENTSEN. Mr. Chairman, thank you very much for holding these hearings. I think they are extremely timely.

Senator Danforth is right when he says you have to and should represent your constituents. It is part of your obligations. Just as he is concerned about TWA, which I understand, I am also concerned about American's purchase of TWA's rights in London. I want to be sure when we are talking about United's purchase of Pan Am's rights that we see that they are even-handed in their treatment on these two deals, that they are given equal consideration and equal timeliness in the consummation thereof.

The other thing that concerns me is what is happening on foreign purchases and anticipated foreign purchases here. When we are thinking about GATT, we are talking about multilateral situations. These airline negotiations, however, are generally bilateral, and there are some advantages, I think, to us in that respect.

But more than in any of these other things, as we see in trade, you see a lot of quid pro quo here. What I am concerned about when we are talking about the possibility of opening up investment here to foreign investment is if we are getting that same kind of reciprocation on the part of the others. If we wanted to buy part of British Air, heavily subsidized, could our investors go in and buy with as much freedom and to the extent that they can here? These are the kinds of concerns to which I hope you will address yourself.

I am looking forward to your testimony, Mr. Secretary.

Senator FORD. We are very pleased to have a new member of our subcommittee, Senator Gorton.

Senator, do you have a statement you would like to make?

Senator GORTON. Thank you, Mr. Chairman. I think I would like to hear what the Secretary has to say, and my statement will be incorporated in the questions that I have for them.

Senator FORD. I would like the Secretary, who has been sitting there listening and can see the large attendance that we have today, to know that we are all anxious and waiting with baited breath for your statement this morning, Mr. Secretary. We are pleased that you are here.

Let me simply say it is the lights that makes the room so hot. It is nothing else. You may proceed.

## STATEMENT OF HON. SAMUEL K. SKINNER, SECRETARY, DEPARTMENT OF TRANSPORTATION; ACCOMPANIED BY PATRICK MURPHY, DEPUTY ASSISTANT SECRETARY

Secretary SKINNER. Thank you, Mr. Chairman and Members of the committee. For the last few minutes I have felt like I am in the gate at the Kentucky Derby waiting for the gate to open. I appreciate the fact that you have opened the gate.

Senator FORD. Yes, but you have laid nothing on the line.

Secretary SKINNER. Just my career, Senator. Just my career.

I am delighted to be here to discuss the airline industry with so many Members of the committee who are well informed and have such diverse interests.

First of all, I do not have to tell Members of the committee that this industry is going through a very difficult time. The airline industry estimated annual loss last year was $2 billion, the greatest 1-year loss in history. Most of that occurred in the fourth quarter and has led to a flurry of proposed transactions among airlines.

Over the last 2 years and most particularly in the last several months, this Department has been working very diligently to: one, set a policy that makes sense from a national basis to address the industry's challenges; and two, to help find solutions to many of the problems that have come as a result of Operation Desert Shield, now Operation Desert Storm.

Before I get into what we have done recently in working with the industry to help them through this very difficult period, let me talk about a couple of things that have occurred since I last testified before the committee on this important issue.

A year ago the Department released the most comprehensive airline competition study ever conducted. It clearly demonstrated that airline deregulation has achieved for the traveler of this country substantial benefits. A month later the President released his national transportation policy containing the framework for aviation reauthorization.

With the help of members of this committee, most particularly Senators Ford, McCain, Danforth, and others, we took significant steps last year to deal with many of the problems that have been identified by the GAO and others in implementing deregulation.

Working together, we provided noise relief for two-thirds of all affected Americans by the end of the decade. We put the U.S. ahead in the area of addressing noise. We came up with a noise program that will result in a much more fuel-efficient U.S. fleet, and we took steps to implement passenger facility charges, which is one of the most procompetitive steps we can take. We published rulemakings 2 weeks ago which will allow PFC's to become effective in anticipation of the July 1, 1991 deadline.

The legislation also maintains a significant level of airport grants, approaching $2 billion annually. This, of course, can be translated into capacity enhancement and more competition at our largest hubs. So we believe we have in the last year accomplished a great deal that will put the industry on a sound footing for the long term.

An analysis of the industry provides confidence that deregulation is working and will continue to benefit consumers. First, airline travel is much less expensive in real dollars. Real fares have declined 28 percent since 1981. Air travel has

increased by 65 percent. Sixty-five percent more people are flying as a result of deregulation, at 28 percent less cost on a real basis.

In an area that has been of interest to Senator Exon and others, essential air service was maintained for critical areas in this country at a level somewhat greater than previous years. Passengers enjoy a wider choice among airlines and more frequent service. The number of airline jobs has grown by 79 percent as of 1989, and safety has not been compromised. Last year the National Transportation Safety Board, an independent agency, found accident and fatality rates had declined steadily since 1960.

The current industry restructuring is a continuation of the process that was under way in the late 1980's. Many of the airlines that face problems today faced problems in the period of regulation. A former Chairman of the Civil Aeronautics Board reminded me that in the early 1970's, Pan Am and TWA appeared before the Board for emergency relief to assist them at that time.

Several factors have recently combined to accelerate this process, such as the slowdown in the economy.

The cost of jet fuel has increased dramatically and fortunately is now on its way down.

Some airlines have never quite adjusted to the rigors of the marketplace and suffered accordingly. Many airlines have added debt, which is a burden they have been unable to sustain. Labor costs are not under control at most airlines. Price distortions have created an unhealthy environment for the consumer.

Let us talk about low airline prices. Last quarter not one major airline in this country covered its operating costs, let alone serviced its debt or returned an investment to its equity holders. Airlines must cover their costs, or eventually they will go out of business.

Consolidation is no grounds for panic and certainly is no grounds for turning the clock back on deregulation. There may be fewer airlines in the 1990's, but even if this happens competition will continue.

As industry consolidates, we should expect low fares which are priced below an airline's cost to disappear. They still will be lower than they would have been in a regulated system had it remained in place.

I would like to address the particular concerns of this committee. Shortly after Desert Shield began, I met with major airline leaders and the ATA. They presented to me a panoply of options and suggestions of steps I could take to help the industry through this most difficult period. Some of those dealt with the management of the air space as it related to fuel conservation, and the FAA has implemented many of those recommendations. Some of the other suggestions that were made enjoyed some support within the industry but not a great deal.

One of the options that was suggested to me by a vast majority of the carriers present at that meeting was to take steps to expand the opportunities that airlines have to replenish capital and to attract capital from all over the world. They suggested that, consistent with Federal law and consistent with U.S. ownership and control of U.S. flag carriers, we could attract foreign capital into the system without compromising on those principles.

At the same time, we had the opportunity to look at the first transaction of that type, which had first been presented to the Department 1-1/2 years ago. That, of course, was the KLM investment in Northwest Airlines.

After examining the ownership and control of that airline for 1-1/2 years, we relaxed the restrictions we had placed earlier due to the uncertainty that had been presented by that transaction concerning foreign investment. First of all, the investment by KLM comes from a country that has a policy of open competition. We are not comfortable allowing foreign ownership to increase where the

ownership interest is coming from a country that offers the same type of opportunities as we do.

This new policy significantly relaxed the restrictions on foreign investment. It did not change the law on control. The law, until changed by Congress, still requires that foreigners hold no more than 25 percent of voting stock and that control be in the hands of U.S. citizens.

U.S. airlines have argued very strongly that they need greater access to foreign capital to enhance competitiveness and allow them to participate in the global economy. If there is one thing that has been clear over the past 2 years, it is that the airline industry is a global industry. The growth will be in international markets. It will be multinational in scope. In many areas, if we are going to survive as multinational and global carriers, our carriers must have the opportunities to not only attract foreign capital but to develop synergies on an international basis.

We also must consider, when making these decisions on an individual basis, whether there is reciprocal access and whether it is available in the investor's country. We cannot undermine the bilateral process.

We also streamlined the carrier selection process to safeguard competitiveness of U.S. carriers. The changes we made were made on a somewhat expedited basis after a year and a half's worth of experience looking at the KLM, Northwest transaction. The carriers that presented that option, as well as a majority of the carriers in the airline industry, asked us to take expedited steps to help them through this most difficult period.

I look forward to working the Congress and explaining some of the things we have done and answering some of the questions they may have. This is a difficult, difficult period. If we proceed in this period with some preconceived notions or some premises that are not based on the current environment, we are most likely going to make some major mistakes. If we stay flexible, if we look at the changing world, we look at the changing global nature of our airline industry, and if we take steps like we did last year to enhance competition through the Aviation Reauthorization Act, we can help this industry through the very difficult period.

And then when we sit back 2 years from now, we will see that the consumer continues to benefit from deregulation, we will have global airlines that will continue to compete on a global basis, and we will have domestic carriers who can survive like the airlines in Arizona and in Texas that have provided such an important niche service in the consumer market.

I welcome your questions. With me is Deputy Assistant Secretary Murphy, who can answer some of the more technical questions if I cannot. Thank you.

[The statement and questions and answers follow:]

STATEMENT OF HON. SAMUEL K. SKINNER, SECRETARY, DEPARTMENT OF TRANSPORTATION

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss recent developments in the airline industry.

Just this past week, we convened a session on airline economics at the Department to focus on what steps are available, in light of current conditions, to address what is a very difficult period for the airlines. Eastern Airlines has ceased operations; Continental and Pan American are currently operating under the protection of the bankruptcy courts; and the U.S. airline industry as a whole has just experienced an annual loss estimated to be $2 billion for 1990—the greatest one-year loss in its history. Most of this loss occurred in the last quarter of 1990 and has led to a flurry of proposed transactions among airlines. I know of your Committee's serious concern over these developments.

The Department has worked diligently to set in place a framework for policy action. One of my first acts as Secretary was to begin the most comprehensive study of the airline industry ever conducted. It was completed just about a year ago and clearly demonstrated that airline deregulation has resulted in substantial benefits for travelers.

The National Transportation Policy, also completed last year, provided the Department with the policy framework to move forward on aviation reauthorization.

Last year's reauthorization legislation is the most significant aviation legislation since airline deregulation. This landmark legislation maintained significant airport grant levels, which can translate directly into capacity enhancement and more competition at our largest hubs. These levels had my personal support.

The Department, the Congress, and the industry, working together, also established a comprehensive policy to deal with the environmental problem of aircraft noise. Certainly the genesis for this unprecedented achievement was right here in this Committee and leadership. The Act's noise provisions will provide relief for two- thirds of all affected Americans by the end of the decade. This policy puts the United States in a leadership position in addressing aircraft noise, and will also result in a much more fuel efficient U.S. fleet.

One of the most important features of the reauthorization is the new statutory power provided local airport authorities to initiate Passenger Facility Charges to finance airport expansion.

The Department was an early and ardent proponent of that significant authority. PFC's will allow the industry to expand significantly in the future. Anticipated PFC revenue streams can support more than a billion a year in new bonding. Many airports may participate in this program, and we have just published a notice of proposed rulemaking which will allow a PFC rule to be in place to meet the July 1, 1991 deadline.

So I believe we have accomplished a great deal over the last two years to provide a sound long-term environment for a competitive and healthy airline industry. Later, I will discuss more recent steps I have taken or plan to take which will aid the carriers in dealing successfully with current economic circumstances and help them to emerge from this difficult period as vigorous competitors.

The airline industry's recent troubles should not be read as an indictment of deregulation. As you know, the Department's study of airline deregulation documented in great detail the enormous benefits deregulation has provided for American travelers, and our ongoing analysis of the industry gives us confidence that these benefits will continue. Other credible studies, such as those conducted by the Brookings Institution, have confirmed our results.

To summarize briefly what our study and ongoing analysis have concluded: First, airline travel is much less expensive. Real airline fares in the United States have declined by an average of 28 percent since 1981. Second, because air travel is now accessible to millions of low- and middle-income Americans, the number of people who travel on scheduled airlines in the United States has increased by 65 percent since deregulation. Last month almost 92 percent of air travelers flew on discount fares. Third, passengers enjoy a wider choice among airlines, and more frequent service. Three times as many passengers now travel in truly competitive markets—those served by three or more airlines—than did in 1978. Thanks to the development of competing nationwide hub and spoke networks, almost all passengers have a choice of carrier and routing in making domestic trips. For example, in the year ended June 30, 1990, 94% of all passenger trips were in markets where at least one competing airline carried five percent or more of the passengers, a far higher percentage than in pre hub-and-spoke days. The airline traveler has not been the only beneficiary; the number of airline jobs has grown by 75 percent too as of 1989. Finally, economic deregulation has not diminished the safety oversight of the Federal Aviation Administration. As the National Transportation Safety Board confirmed a few weeks ago, accident and fatality rates have declined steadily since the 1960's. And 1990 was one of the safest years ever.

The current industry restructuring we are seeing is a continuation of the process that got underway in the late 1980's. It is in some ways the inevitable result of market forces unleashed by the Airline Deregulation Act of 1978. The reason so much seems to be happening today is that several factors have recently combined to accelerate the process.

The recent slowdown in the U.S. economy has reduced the demand for air travel. This sluggish demand has come at a time when airlines have added new planes and new services. This has contributed significantly to current carrier losses.

The cost of jet fuel increased dramatically following Iraq's invasion of Kuwait in early August. Jet fuel is a major component of airline operating costs, second only to labor costs. Each one cent increase in the cost of a gallon of jet fuel imposes an extra $164 million in operating cost on the industry. Also, Kuwait was a significant factor in the supply of aviation jet fuel. I am gratified to see that prices have dropped dramatically from their November peak in the $1.40 range to the present levels in the low 70-cent range.

Airlines were given greater latitude under the free market principles of deregulation. Some airlines never quite adjusted to the rigors of the marketplace and suffered accordingly. Others took on massive and excessive debt, and have found it difficult to service that debt in a slow economy. To some degree airline management and the investment community are themselves responsible for the industry's current situation.

Finally, most airlines have not been able to bring all their costs under control. For example, the average airline worker—including reservation agents, ticket clerks, janitors, and baggage handlers-makes approximately twice the national average wage. When pilots at one major airline average nearly twice what their colleagues earn at another airline, one might question whether something is seriously out of balance in the airline labor market.

I believe uneconomically high costs create an unhealthy environment for the consumer. In the end, of course, the consumer loses. Either consumers must pay for high industry costs through higher fares, or airlines will continue to hemorrhage financially.

Of one thing we are confident: consolidation is no grounds for panic. There may be fewer airlines in the 1990's than there were at the end of the 1980's. But even if this happens, we have every reason to believe that robust competition will continue. Under the system of competing nationwide hub and spoke networks which has developed under deregulation, existing carriers can serve most major markets in the nation on a one- stop connecting basis. As a consequence competition should continue to thrive. Further, vigorous antitrust enforcement can be expected to prevent anticompetitive airline mergers. The Department of Justice's decision last week to contest the sale of Eastern's slots and gates at National is a good example. Our Department worked closely with Justice on that matter.

The recent financial difficulties of the industry have produced almost desperate marketing strategies by some carriers and some incredible air fare bargains. But we know that unrealistically low prices are a bad bargain in the long run. Airlines must cover their costs or eventually go out of business. We should expect that as the industry consolidates further, which is likely, some of the lowest fares will disappear. When some of these bargains disappear, consumers should understand that the increase should not be blamed on deregulation. Had it not been for deregulation, fares would have been higher than they are now and service options lower. But in the long run, fares must cover airline costs and will still be lower than they would have been but for deregulation.

As the industry continues to restructure, the Department will take aggressive steps to sustain and enhance airline competition. I know the Committee's interest today centers on increased foreign ownership of U.S. air carriers, and on the Department's oversight on international route transfers.

Recently, the Department announced a new policy which will significantly relax previous restrictions on foreign investment in U.S. airlines. This new approach is an acknowledgement of the changing nature of the airline industry, as the integration of domestic and international operations is moving the industry toward one of truly global airline companies. We believe that it is important that our airlines be given greater access to foreign capital to enhance their competitiveness both domestically and internationally and allow them to participate in this globalization process.

The announcement of our new policy at this time of economic hardship in many segments of the industry is especially beneficial. The policy, however, was not adopted simply to address a short-term economic problem, but rather is the product of many months of serious thought and study.

The first case involving substantial foreign investment in a major U.S. carrier after I became Secretary was the purchase of Northwest Airlines by Wings Holdings in 1989. Since that time, there have been a number of cases involving foreign investments in both large carriers, such as Continental, and smaller regional and commuter carriers. My review of these cases has led me to conclude that, in many areas, it is possible to allow our carriers substantially greater latitude in obtaining foreign funding for their operations and their long-term future growth. Our carriers must be positioned to compete fairly and vigorously in the changing international industry.

The current legislative limits on foreign ownership and control are contained in section 101(16) of the Federal Aviation Act. This section requires that the president and at least two-thirds of the board of directors and other managing officers of an air carrier be U.S. citizens and that at least 75 percent of the voting stock in the company be owned or controlled by U.S. citizens. Historically, the Department, and the Civil Aeronautics Board before it, have interpreted the statute to require that a carrier, in fact, be under the actual control of U.S. citizens. This has not changed. We have, however, reexamined and refined our application of the "control" test to ensure that it's fully consistent with today's realities. Our new policy will allow greater foreign ownership of equity—up to 49 percent—while keeping foreign ownership of voting stock to the 25 percent statutory limit. We have also decided not to view debt as a foreign control issue, unless the loan agreement provides special rights to the foreign debt holder that imply control. We will also allow foreign membership on airline boards to reflect voting stock ownership—as long as it satisfies the statutory ceiling, and as long as representatives of foreign airlines do not take part in decisions affecting competition.

There are arguments for having a statutory citizenship requirement. There is a need for quick access to civilian airlift capacity in times of national emergency, as Operations Desert Shield and Desert Storm have shown. Also, in international aviation, landing rights are parceled out through narrowly drawn bilateral agreements. The U.S. has been the leader in opening up international markets to competition. If we are to maintain the leverage we need to open more foreign markets to U.S. carriers, we have to maintain oversight of the extent to which foreign carriers enjoy access to our market through investments.

Many of you have expressed the view that the Department should, in exercising its authority under the foreign ownership statute, consider whether the investing nation allows U.S. citizens to invest in foreign airlines. I have a great deal of sympathy for that view, because we cannot allow foreign carriers to undermine the bilateral negotiating process by purchasing access to the lucrative U.S. market. Let me assure this Committee that we will not be unmindful of these considerations as we seek to attract foreign investment to U.S. airlines.

In our exercise of our authority over international route awards and transfers, we intend to place even greater emphasis on safeguarding the competitiveness of U.S. carriers. The availability of

international routes is generally limited to rights negotiated in bilateral treaties and the Department must select among carriers to serve these limited entry markets.

As you know, we are seeking ways to streamline what is today a time- consuming, expensive and inefficient process of selecting carriers. This does not contemplate a change in the statute or in the substantive criteria applied to carrier selections. Rather, I believe the process could be simpler and quicker, and I've asked the staff to look into the question. I do not intend to deprive the carriers or affected communities of their opportunity to participate in proceedings.

We are also seeing a lively "secondary market" for international routes where carriers that have obtained international authority are seeking to sell established routes to other carriers. I believe that the market can be an effective means of allocating international route authority, as long as the transactions are consistent with competition and the economic health of the U.S. airline industry. For example, Pan Am's sale of its Pacific routes to United in 1985 and Eastern's sale of its Latin American routes to American last year have produced a net dividend for the public. While we do not have any intention of "rubber-stamping" every transaction we review, where there are no impediments to competition or where a transaction promises to enhance competition, our disposition is likely to be favorable.

As the airline industry continues to restructure to meet the new realities of the changing global marketplace, the Department is committed to doing all it can to assure that the enormous benefits of deregulation are maintained in domestic markets and expanded to international markets. Airlines for their part must continue to look beyond our borders, whether by flying internationally themselves or by entering into agreements with foreign carriers. It is most essential that airlines keep their costs under control.

Failure to do so will ensure that no one wins: not employees, whose jobs will be placed at risk; not airlines, who may be forced out of business; and certainly not consumers, who will ultimately foot the bill through higher fares. We at the Department are optimistic that the industry will weather the current storm and remain vigorously competitive. We will use the tools at our disposal to insure that that happens. I look forward to working with the Congress to achieve this goal.

Mr. Chairman, this completes my statement, and I would be pleased to respond to any questions you or members of the Committee may have.

THE SECRETARY OF TRANSPORTATION,
*Washington, DC, April 11, 1991.*

THE HONORABLE WENDELL H. FORD,
*Chairman, Subcommittee on Aviation, Committee on Commerce, Science, and Transportation U.SA. Senate, Washington, DC.*

Dear Mr. Chairman:

Enclosed are responses to the additional questions by Chairman Hollings and Senator Kerry to be answered for the record of the Committee's recent hearing on foreign ownership in the domestic airline industry and transfer of international routes.

I appreciate the opportunity to provide our views for the record.

Sincerely,

SAMUEL K. SKINNER, *Secretary.*

Enclosure

## QUESTIONS OF THE CHAIRMAN AND THE ANSWERS THERETO

### FOREIGN OWNERSHIP

*Question.* In permitting greater foreign equity investments in U.S. carriers, how will you be able to guarantee reciprocal rights for our carriers in foreign countries? What is the incentive of a foreign country to open up their country through a liberal entry policy if we permit that country's carrier to purchase an interest in a U.S. carrier?

ANSWER. We propose to link liberalized foreign ownership to the state of bilateral relations with the foreign investor's homeland. We would only approve liberalized foreign ownership il bilateral relations with the other country generally, as well as the terms of any relevant bilateral agreement, justified it. We would also assure ourselves that any laws of that country allowed similar access to its carriers by U.S. investors. A failure to permit reciprocal rights for U.S. investors, while not necessarily fatal to such permission here, would certainly weigh heavily against continued liberality, both with regard to foreign ownership and in the bilateral relationship generally. There are no guarantees, as such. However, the usual mechanism of bilateral give- and-take should provide an adequate safeguard.

*Question.* One of the points you raised in the 1989 KLM-Northwest consent order concerned the loss of actual or potential competition between the carriers. Yet the 1991 final order does not discuss it at all. What factors did you consider in this regard and how did it change your views?

ANSWER. We did not find that the modest revisions to the relationship between KLM and Northwest that were the subject of our 1991 order represented a fundamental change in, or threat to, the competitive climate, so no new analysis was necessary. The conditions imposed in 1989 that addressed that concern are still in place.

LABOR COSTS

*Question.* You continue to harp on labor costs in speeches and in testimony as a reason for higher prices and industry problems. Yet, those wage rates are negotiated at arms length, and, in fact, those carriers with the highest salaries are considered to be the stronger carriers, while some of those with lower labor costs are not. It strikes me that debt loads are a major problem, which was brought about by DOT merger policies. I would appreciate if, for the record, you would provide your analysis with specific data to back up your assertions with respect to labor costs. ANSWER. I hope my observations about the totality of industry costs, and how they are an area each carrier management must constantly reassess to remain competitive, are not misunderstood as an attempt to make labor a scapegoat for the current difficult circumstances across the industry. I have emphasized the run-up in fuel prices and security concerns because of the Persian Gulf war, along with the recessionary aspects in the current economy, as being the factors driving the current situation. My point on costs is simply that the days of passing them through to the consumer are over, whatever costs may be at issue.

ROUTE/SALES/TRANSFERS/AWARDS

*Question.* Under current DOT procedures, in limited entry markets, carrier selection cases are held to determine which carrier would best serve the public interest. These cases provide a comparative look at carrier service proposals and thus require a thorough analysis. You have now indicated on at least two occasions that you intend to expedite these cases, and have stated that the hearing process is time consuming, expensive, and inefficient. What sort of a shortened process are you considering? How can you assure us that all relevant factors will be considered and evaluated under such procedures?

ANSWER. We are examining various procedural options that might shorten deadlines or otherwise streamline the regulatory process. As our numerous non-hearing procedures indicate, it is quite possible under certain circumstances to perform an appropriate analysis of public interest factors without necessarily resorting to oral hearing procedures.

*Question.* Concerning route sales, and the subsequent need for DOT approval of the transfer of the certificate, we have heard a number of complaints about the process, or lack of a process, in reviewing the transfer of route certificates. Some transfer requests take a few weeks, yet others can take a year. Why shouldn't there be specific procedures established so that all parties will know what the process will be?

ANSWER. First, I must distinguish between two separate issues raised in the question: the process used in a case, and the time that process consumes. The process employed is a function of what procedures we think are necessary to create a complete record that illuminates any relevant issues; more process than is necessary simply wastes time and resources for all involved. Subpart Q of 14 C.F.R. Part 302 sets forth the general parameters of the procedures employed. Parties to the proceeding are fully informed of specific procedures selected in individual cases through notices or orders issued and served on the parties. Even where the same s

process is used, however, the time consumed may vary according to the size of the record, how long it takes to receive a complete application, and the number of parties, issues, and pleadings involved.

*Question.* Doesn't the "secondary market" for routes, which may provide some short-term relief to ailing carriers, ultimately merely hasten further industry consolidation, which was started during the last Administration? Why should we allow the strong carriers to get stronger at the expense of consumers?

ANSWER. Such consolidation may actually be slowed where (as in Pan Am-United) the transaction has the potential to improve a carrier's chances for survival. After all, even if we had rejected that transaction and the carrier had ceased operations, the international routes would then have had to be reallocated. If we had then parceled out the routes to existing carriers, there would have been no more carriers in the industry than there are now as a result of approving the transaction. Moreover, even accepting the argument that the strength of the larger carriers may be increasing to consumers' detriment-an argument I find unpersuasive-there is no reason to assume that the 401 (h) process is accelerating this effect.

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## QUESTIONS OF SENATOR KERRY AND THE ANSWERS THERETO

*Question.* Why was there no oral evidentiary hearing by the DOT preceding the Final Order of February 6,1991, in the United- Pan Am route transfer case?

ANSWER. The Department generally does not conduct an oral evidentiary hearing in proceedings where there appear to be no material issues of disputed fact that would be readily developed only in a hearing context. In this case, while a number of factual issues were presented, we saw no need for an oral hearing to resolve them. Most of the issues presented involved points of law or policy rather than fact.

*Question.* According to Section 401(h)(1), a route cannot be transferred unless it is in the public interest. Is it your feeling that the United Pan Am route transfer is in the public interest; and if so, what are your specific reasons for your conclusion?

ANSWER. We definitely feel that the Pan Am-United transaction is in the public interest, and indeed specifically made that finding and so certified to Congress. The Department's reasons are set out in its show-cause and final orders, copies of which are attached for the Committee's convenience.

*Question.* At the February 19,1991, hearing before the Senate Aviation Subcommittee, you testified that Pan Am would be in Chapter 7 liquidation today if the London route transfer did not go through. What are your reasons, Mr. Secretary, for coming to that conclusion?

ANSWER. I was aware of the carrier's acute financial distress and the alleged need for approval of that transaction for it to secure additional funds.

*Question.* Mr. Secretary, were you aware that Pan Am has an $840 million pension underfunding, and that Pan Am declared Chapter 11 on January 8,1991?

ANSWER. I was aware of Pan Am's bankruptcy filing. I was also aware of allegations of Pan Am's pension underfunding, but not necessarily of the specific amount.

*Question.* According to the facts we have, American Airlines had bid $200 million more for Pan Am's routes than United, plus there were three more bidders. Mr. Secretary, were you aware of this before issuing your Final Order?

Mr. Secretary, what are your reasons for issuing the Pan Am route to the lowest bidder?

ANSWER. I believe I should correct a faulty premise of these two questions—namely, that the section 401(h) process involved some kind of "bidding" process. There was no auction, or any similar proceeding, held at the Department of Transportation for Pan Am's routes. Rather, a prospective buyer and seller applied to the Department for approval of a transaction. That was the only application before us. Finding it to be in the public interest, the Department approved it.

*Question.* Would it not have been better for DOT to have held an oral evidentiary hearing and to have allowed the routes to go to the highest bidder so as to minimize the ultimate cost to the tax payer?

ANSWER. As already noted, the 401(h) process does not involve bidding. In any event, it is by no means clear to me that an oral evidentiary hearing would have changed the outcome of this case.

Senator FORD. Thank you, Mr. Secretary. I know you have another appointment and you would like to get away fairly soon, so I will ask my colleagues—I will not put the light on, but I would ask them to hold their questioning to somewhere around 10 minutes each. Then maybe we can get the Secretary off to his next scheduled appearance.

Mr. Secretary, the Federal Aviation Act requires that 75 percent of voting interest be controlled by U.S. citizens and that two-thirds of the board be U.S. citizens. In 1989, you and I discussed control particularly in relation to KLM-Northwest. You told me at that time that you only had two alternatives with respect to acting on an airline acquisition: jawboning or jerking the certificate. Of course, the latter was very distasteful, but you had that as a last resort. Instead you required that KLM reduce its equity share from 50 percent, or over 50 percent, to 25 percent and only have one KLM member on the 12-member board.

Yet in January this year within 3 days after you were petitioned, you announced liberalization of foreign investment posture in that particular airline to allow equity investment up to 49 percent. As I read in the financial pages that Northwest owed approximately $250 million for a payment at that time, and by allowing KLM to go from 25 percent to 49 percent, that made the payment. It also gave Northwest the ability then to move in and to buy Eastern assets. So it indicated that if they had made their payments under the normal payment schedule, they could not have purchased the assets nor would you have been requested to go from 25 percent to 49 percent. You say this does not constitute control since it is not voting stock. But KLM also got to appoint three board members when they expanded the board from 12 to 15.

The move was made very quickly. The Northwest payment was made by letting KLM acquire 24 percent additional equity in Northwest, Then Northwest was able to buy parts of Eastern. Is that basically the route that was travelled? It is what seems to be on the surface, Mr. Secretary.

Secretary SKINNER. Let me see, first of all, if we can agree on the factual situation. When the transaction was first presented to us, it was a unique

transaction. And the equity amounts that were presented to us were in excess of the 25 percent. At no time have we ever allowed or considered allowing KLM to have more than 25 percent of the voting equity. When looking at the total equity——

Senator FORD. Now wait a minute, voting equity.

Secretary SKINNER. Right.

Senator FORD. Okay. Well the money that was placed into Northwest is 49 percent.

Secretary SKINNER. Right. We then, because of the uncertainty of the transaction at that time, because we had new owners—Mr. Checchi and his group, who maintained that they were in control—out of an abundance of caution, we required Northwest to divest itself of a certain amount of the non-voting equity. We gave them a period of time to do that. This, therefore, was pending before the department. We gave them at least one extension on the deadline because they were unable during very difficult times to unload that equity, and it was becoming quite clear to us that Mr. Checchi, Mr. Malek, and Mr. Wilson were totally in control of that airline based upon their performance.

This transaction was pending before the department, and they petitioned the department, during Operation Desert Shield when fuel prices were going sky high, to release them from the obligation to disinvest. We did that because number 1, we were satisfied that U.S. control existed and that the other statutory requirements of the law were met.

Now let us talk about what people perceive the airline industry will become. The difficult challenge facing the policy makers in this department and in government is ensuring that we have as many carriers as we possibly can. Typically most people put on their list of the carriers they believe will survive this: American, United, and Delta. Others believe that there are other carriers who can survive if given the opportunity to compete, access to the marketplace, and the proper ability to attract capital from foreign sources.

As result of the Northwest transaction and other steps we have taken in other transactions, Northwest soon will open up a substantial position at Washington National. They will begin to be an East Coast carrier to complement their entire network. We worked very closely with the Department of Justice Anti-trust Division on that transaction. As a result of that transaction, and the buying of Eastern gates and slots, we will have more competition at Washington National than we would have had before.

Had they not been able to attract foreign capital, especially during this difficult time, they would not have been able to purchase those gates and slots. We would not have the enhanced competition at Washington National that we anticipate having. At the same time, Northwest, recognizing the opportunity to participate in the East Coast, is looking at going into Atlanta to replace Eastern, and is being recruited very vigorously by the government officials in Atlanta to be the second carrier in Atlanta. Without a substantial East Coast network, they would not be able to do so.

As a result of our foreign investment decision—which did not affect our restriction on control, did not affect the limit on statutory voting equity, and ensures that U.S. citizens run that airline, we have still allowed them to enhance their competitive ability and enhance competition at Washington National and hopefully along the entire East Coast where Eastern was such a dominant player.

Senator FORD. Mr. Secretary, if Northwest had not been highly leveraged, would it have been necessary to get foreign investment?

Secretary SKINNER. Well, every major carrier has foreign investment in its equity and debt structures.

Senator FORD. 49 percent?

Secretary SKINNER. Well, not at 49 percent.

Senator FORD. Well, then 10 percent or 12 percent?

Secretary SKINNER. It varies from airline to airline.

Senator FORD. But not nearly as much as 49 percent.

Secretary SKINNER. The problem that you identify is a real one. And you and I talked about it some time ago. If an airline restructures substantially or excessively, they are not prepared to meet the problems that are presented to them in situations like this.

There is one reason that American, Delta, and United are not in the same position that many of these other carriers are. The United LBO did not go through. The American transaction by Mr. Trump did not go through. And Delta has a unique structure and never really was a target of a takeover or a leveraged buy-out operation. That does not mean those other airlines cannot survive, but they are going to have greater challenges as a result of the heavy leverage. Because in tough times, if you cannot cover your operating costs, you certainly cannot service your debt, and you certainly cannot give something back to your equity holders. And that, in itself, is not an inducement for people to put more money into equity.

So the heavily leveraged position has compounded the problems for Northwest and others.

Senator FORD. Is it correct to say that the moneys invested by foreign carriers and airlines would return more to the foreign airlines if they just invested their money and drew interest, rather than invest in the airline?

Secretary SKINNER. Well unfortunately, if you ask foreign airline heads about their investments in U.S. carriers, they would say it has been a very bad experience for them. They have not received the kind of returns that they want, and in many cases, they have lost a good portion of their equity. If the United transaction had gone through and British Airways had made their $750 million equity investment, I was told by British Airways authorities, that probably would be worth about $300 million today. So there have not been good financial return on the investments that have been made.

While there have been, Senator, some synergies in international travel and code-sharing and other things, they have not been good investments based on their return.

Senator FORD. Well, under those circumstances, it would lead me to believe they would be more interested in acquisition of the American domestic airline business than in profit on their business. So I am not sure that they did not expect to lose some money, hopefully they would not. But it gives me the impression that regardless of what occurs, they are buying into the domestic market here, which will ultimately be a profit for them.

I think my time has about run out. But I have one question that Senator Inouye asked me to put to you. Senator Inouye is in the Persian Gulf at this present time.

The question is this, Mr. Secretary.

Hawaiian Airlines proposes to sell their route from Honolulu to Western Japan to Northwest Airlines before beginning service on that route. Although there is no bar to this, Assistant Secretary Shane has stated that the Department would not, under normal circumstances, favor a sale before service is initiated.

The inference is that the bar is not absolute and that you would consider the facts of the case.

Senator Inouye wants to know, is this a correct understanding?

Secretary SKINNER. Well, we announced several months ago that every airline route transfer would have to be analyzed, because routes had been awarded

through a very complicated process and these awards were made on what was supposed to be the best interest of the American consumer, and that an automatic rubber-stamped transfer of a route transfer, where the acquiring carrier had not met many of those objectives, could not be assumed.

Having said that, we have gone through that process. In some cases route transfers have been approved. In other cases they have not been approved. In the case of Hawaiian, it is pending.

Normally, in the Department of Transportation if a carrier has not served a route, ever, and there is a backup carrier who is waiting to serve that route and will serve that route, and the first-choice carrier decides not to serve the route, it normally falls to the backup carrier whose selection was made what is in the best interest of the American traveling public.

That policy continues to be our general policy. We never say never. The Hawaiian case is pending before the Department. Many carriers have objected to the transfer of that route, especially a route that has never been flown. And we will have to look at all the pros and cons of that transaction before we make a final decision.

But you can assume that we will go through the regular process of the Department in the case of transferring a route that had never been flown.

Senator FORD. Thank you, Mr. Secretary.

Senator McCain?

Senator MCCAIN. Thank you, Mr. Chairman. Thank you, Mr. Secretary.

I must say at the outset that I disagree with the premises on which you base your statement. I am not sure how logic would indicate that a smaller number of airlines, which basically you have prognosticated, leads to, as you stated, lower airline fares and more service.

It does not compute to have a situation where you have fewer and fewer airlines and can expect more and more competition when history shows us that every time a airline has fallen out of a route, the prices, the fares have gone up. There is a clear record of that.

The latest example is the increasing United fares that I just mentioned in my opening statement.

So I disagree with the basic philosophy that apparently is the Administration's position since, Mr. Secretary, you just said, I did not have a written copy of your statement so I cannot quote it directly, but you said that 2 years from now we will still have lower fares and better competition, et cetera. 2 years from now, Mr. Secretary, will Pan Am and TWA be in existence?

Secretary SKINNER. Nobody can answer that. Those airlines, one of them is in bankruptcy and one has defaulted on its debt.

As I mentioned in my remarks, Senator McCain, both of them have been in trouble for 30 years. They were in trouble in 1974 when they sought relief from the Civil Aeronautics Board during the period of regulation.

I do know, however, that both airlines have come to the Department and represented that they will not be able to survive if they are not able to transfer their remaining London routes.

The best way to insure that they have no chance of surviving—at least in the case of the United transaction with Pan Am that has already been decided, that everybody agrees that, absent the cash flow from the route transfer, they would be in Chapter 7 liquidation today—would be to disapprove a transfer.

So there is one thing of which I can assure you. If we do not get access to Heathrow for those two carriers, and those transactions do not go through, they will be filing for Chapter 7 liquidation.

Senator MCCAIN. Well, one thing I can assure you of is that if any company or corporations sells off its most valuable assets, you are putting a life support system on a corpse.

And so, to somehow believe that by selling off their most lucrative routes, as Eastern did before they just went out of business, and somehow survive and limp along for a few weeks or months and then go under, is frankly not what I believe that airline deregulation had in mind.

Mr. Secretary, the GAO calculated that American and United each receive over $300 million per year in excess of the cost of CRS services provided including a reasonable profit from other carriers in the industry, most of which are financially weaker.

In other words, United is able to cover the $290 million cost of its purchase of Pan Am's London routes with less than a year's worth of excess CRS profits.

Could you please tell me how the Department's policy of allowing these valuable routes to go to the highest bidder prevents the big from getting bigger?

Secretary SKINNER. First of all, that is not our policy. It does not go to the highest bidder.

Each transaction is looked upon on its own.

On the issue of CRS, if I could just address it for a moment. I met last week with the committee working on that and I anticipate that we will be moving the CRS rule very soon, which will make some very needed changes to the current status on CRS's.

Putting CRS aside for a minute, because I cannot talk about that until it becomes public, I can assure you that every transaction is looked at comprehensively. Some are rejected.

As Chairman Ford just indicated a moment ago, there is a transaction pending right now before the Department involving Northwest and Hawaiian, which is being looked at very carefully. There are a lot of comments from a lot of people. In fact, the last comment was filed on Friday.

And that transaction will be examined individually, just as the United transaction with Pan Am was looked at individually and just as the American-TWA transaction is being looked at as we speak.

Senator MCCAIN. Last Thursday, as you know, Mr. Secretary, the Department of Justice announced its opposition to United's purchase of the Eastern slots and gates at Washington National. In the view of Justice the sale would be anti-competitive and lessen competition.

How are you going to adjust your rule making on slots in order to incorporate the Justice Department's concern with competition at slot-controlled airports?

Secretary SKINNER. The concerns expressed by Justice parallel our concerns. And as I said, we were in close consultation with Justice prior to the making of that decision.

We share their opinion and we think that was the right decision.

Our slot-making rule, which I also discussed last week, is in its very final throes. There will be certain options that will be available to the industry that we believe will facilitate the offering of slots at reasonable prices to new entrants or smaller airlines that do not have slots. That proposal is required by the FAA reauthorization legislation and we anticipate that rule going to OMB any day.

So I think action in this quarter or early in the second quarter will deal both with the CRS rule as well as the slot rule.

Senator MCCAIN. Finally, Mr. Chairman, Mr. Secretary, it is clear to any observer that there is going to be more and more of a consolidation, which means there will be more and more sales of routes, slots, et cetera.

I guess the final question I have is whether it is your policy to simply go along with awards to the highest bidder or are you going to develop policies designed to assure that smaller carriers can participate meaningfully in attempting to obtain assets in these proceedings, none of which we have seen so far in the sale of both routes and slots?

Secretary SKINNER. Well, number one, every transaction is looked upon thoroughly. Some are approved. Some are not approved. The decision is made based on what is in the best interest of the American people.

I should say that in these times of sales of international routes, most of the sellers have been the smaller carriers and the acquirers have been the bigger carriers.

In the case of Continental, which is in the process of selling some of its routes, it was negotiating on the sale of some of its routes with several carriers. So even the big carriers on some occasions have been selling some of their routes.

In our award of routes recently to Japan we made an award of routes to a multitude of carriers, both big and small who now have the opportunity to serve the Pacific rim.

So every decision has to be made on its own set of facts.

Senator MCCAIN. Well, Mr. Secretary, my question was not about new routes, but what assets are going to be sold as airlines go under as we all know they are?

Secretary SKINNER. I think United, one of our nation's biggest carriers, was the highest bidder. And the Department of Transportation advised the Department of Justice that that transaction was not, in our opinion, the most competitive transaction. The Department of Justice came to the same conclusion.

And, therefore, those gates and slots went to Northwest, which has no position of any significance at National and now will.

We also hope as a result of our slot-making rule that carriers like those you have been interested in and those that people in the State of Wisconsin have been interested in will have an opportunity to buy slots on a reasonable basis.

Senator MCCAIN. Thank you very much, Mr. Chairman. Thank you, Mr. Secretary.

Senator FORD. Thank you. Senator Hollings?

The CHAIRMAN. At a certain point, Mr. Secretary, we have deregulated, and now we have come full circle to regulation. Instead of the Civil Aeronautics Board we have bankruptcy courts. We are now back under regulation.

I know that this hearing is on competition, but since you raised the question in a bragging manner that 1990 was one of our safest years, we know by now that 1991 is one of our most unsafe. Mr. Secretary, it really singes my conscience with respect to that crash out there in Los Angeles.

Secretary of Transportation Dole 10 years ago had a 10-year study showing that to upgrade the safety at the airports of America would be some $20 billion and that we ought to be expanding at least $2 billion per year doing that. I pursued FAA Administrator McArtor and others as they came before this committee to just give us a plan. We did not have a particular airport in mind, but we just wanted a national plan to let us start spending the money that the air travelers have paid into the trust fund. The administration would never allow that. They wanted that money for the deficit; read our lips, we are against taxes.

So we can't spend the trust fund, and safety falters, and 34 get killed because, in addition to the controller error, we have a communications breakdown. The radar was not a new generation radar. The surface safety radar was not in place. There were obstructions on the field.

It seems to me, Mr. Secretary, without just going into the detailed investigation of that, that there ought to be a general policy by way of spending the money that

we air travelers—because all of us travel now in and out practically every week by air—have paid into that trust fund to bring the airports of America up to safety snuff. Specifically, we have increased last year the 8 percent on the tickets to 10 percent. We will get $4 billion in, and we already have in the trust fund $7.4 billion unexpended that we are using for the deficit.

I noticed in the morning news that the AFL-CIO and others are calling for a jobs program in the recession. Here we have a need to recover from the recession, a need for a jobs program, a need for safety, and the money is there. What they cannot understand outside the Beltway, is why we do not have the common sense up here to get to work, and start letting the contracts and start moving forward to at least get safer airports for whatever airlines are going to remain to serve them. The plan has already been studied. You do not need another study.

What is your plan to do something about that? Let us start spending the money in the trust fund and getting more safety.

Secretary SKINNER. Let me address several issues, and then we will talk about the accident.

This year in the FAA budget, the request for 1992 is $9.267 billion, up from $8.138 billion, a 14 percent increase. We have increased over a period of time expenditures for aviation from about $5 to $9.2 billion. We are spending money in aviation about as fast as we can spend it.

Second, if a technical adjustment is made to the Budget Reconciliation Act concerning where the ticket tax money is going to go, by the end of 1992 we will have begun to spend down the trust fund substantially, as a result of the bill that was put together by this committee and committees in the Senate and the House.

The CHAIRMAN. When will that be spent down?

Secretary SKINNER. I have not got the exact number, but the number I saw was—let me see if I can state this exactly.

The CHAIRMAN. Did you say you have $5 billion in contracts out now? Is that what you said?

Secretary SKINNER. No, no. What I am saying is the trust fund balance, if the Congress corrects the technical error——

The CHAIRMAN. I am asking what money we are spending. You can get me these balance figures, but then the balance is determined by how much you pay for the deficit.

Secretary SKINNER. The trust fund surplus will decline by about $1.8 billion to $5.8 billion by the end of 1992 if the technical adjustment goes through that was intended on the ticket tax.

The CHAIRMAN. So you are spending $1.8 billion, I take it, now?

Secretary SKINNER. Right.

The CHAIRMAN. We are still shy of what the needs were determined to be some 10 years ago.

Secretary SKINNER. Well, we increased F&E, which is the equipment budget, from $2 billion to $2.7 billion, a 29 percent increase this year. Operations went up 10 percent. AIP went up 6 percent. Research went up 2 percent.

Now let us talk about the accident in Los Angeles. First of all, the year is not over, Senator, and we will have to wait until the end of this year.

The CHAIRMAN. Oh, you get the averages. I know. I did not get into the subject of averages about the prices going down, because I can prove my case. I have to pay it every weekend. The medium-sized airports of America are subsidizing the long-range profitable hauls to Las Vegas, Los Angeles and out west and back and forth. So we are the ones who are suffering. You cannot tell this Senator or anybody who goes to the medium-sized cities of America that prices are down.

They have gone sky high through the ceiling. Now you are going to give me the average on safety.

I am telling you right now we did not have the right equipment out there. We have been asking for it. You have not been spending the money. For 10 years this administration has been talking about deregulating and spending it on the deficit, and that is a fact.

Secretary SKINNER. We are spending more money than we have ever spent. It has gone up about 60 percent over the last 7 years.

The CHAIRMAN. Do not give me the percent. How much money have you spent?

Secretary SKINNER. Well, it went from $5 billion to $9 billion.

First of all, it appears to be a human error involved in the L.A. crash. Unfortunately, with 17,220 controllers occasionally they are going to make tragic human errors. Nobody feels worse——

The CHAIRMAN. How about the controller that was not there? They have been trying to get additional controllers on, and they did not have the additional controller on in Los Angeles.

Secretary SKINNER. We should wait, Senator, until the National Transportation Safety Board report is in. This committee has suggested to the Department we should wait until the complete inquiry is in.

Let me say I have personally visited there. All the controllers on duty were full performance level controllers. It would appear that equipment would not have solved that problem. The technology is not available to solve that problem. When it is all over this year, looking at the totality of the system and the number of operational errors, we will have another year better, Lord willing, than last year.

Every year for the last several years, 17,200 controllers and growing are doing a better job to manage the air space system of this country and doing it safer, and that is what the NTSB said. As you know, they have not always supported the positions of the Department.

So I am convinced that, as tragic as that accident was, we are spending money as fast as we can. The President has supported the budget and the operations of the FAA more than for any other department, with maybe one exception, in the entirety of government. We are spending money about as fast as we can, and that technology will come on line.

In the meantime, everybody is working very hard to make sure that human errors are held to an absolute minimum.

The CHAIRMAN. Well, we know what you are saying, that the equipment was not available, it was not ordered. We know what you are saying, that the administration is all set for safety and everything else, but they are the ones who are demanding that the trust fund not be a trust fund. We added on the 2 percent that would go into the general fund, and not to the trust fund.

So we know the track record with respect to the approach to safety of this administration, and I want to see that $5 billion worth of contracts that you are talking about because I do not believe it.

We are going to get a lot of testimony. You say it is not equipment error, and we will wait for that safety report to come in. In addition to controller error, it was also equipment error. We are reading about it and seeing it, and we understand that to be the case, and we are still talking about spending trust moneys this year for the deficit rather than for safety.

Senator FORD. Thank you. Senator Exon.

Senator EXON. Thank you very much. Let us go back, if we might, Mr. Secretary, to the matter that Senator McCain brought up. I was very pleased to

see last week that the Justice Department, I guess with your encouragement, did decide—I cannot see how anybody could not have thought that United getting those additional slots of Eastern would give them a monopoly that would be anti-competitive.

Now the slots as I understand it—have you approved, then, the slots that United failed to obtain because of the Justice Department's ruling, have you awarded or agreed to give those to the second highest bidder, which I believe was Northwest?

Secretary SKINNER. Northwest, as it turned out in bankruptcy court, raised their bid to equal the United bid. The bankruptcy judge approved the transaction, and when they request the transfer of those slots, the FAA will approve that transfer.

Senator EXON. Just for the history, so that everyone understands, on this whole slot business, if I remember correctly, was it 1985 that the then Reagan administration made an executive decision that in effect gave and cemented in place all of the slots then existing to the airlines that held them in the various airports. Is that right?

Secretary SKINNER. I am not sure. I do know that as to National, which is of primary concern, the slot restrictions are part of the bill that transferred the airport to the Washington Metropolitan Airport Authority——

Senator EXON. Well, forget that. Maybe I did not understand. This whole matter of slots——

Secretary SKINNER. Yes, sir, the buy-sell rule went in 1985.

Senator EXON. And is it fair to describe that as an action by the Reagan administration that gave the airlines a sizable amount of money when that happened?

Secretary SKINNER. Well, when the buy-sell rule went through, and the slots were grandfathered to those that held them, they immediately had value and were subject to transfer for value, so the answer is yes.

Senator EXON. And that continues as of today, as was and as the case is about to happen, that those slots will be owned by Northwest?

Secretary SKINNER. That is right.

Senator EXON. Do you think that this whole business of slots being owned by the airlines should continue indefinitely? What is your position? What are your thoughts on that? Do you think that is good, bad, or——

Secretary SKINNER. I have a button that my staff gave me because I have been wrestling with slots for two years. It says, "I hate slots." That about sums up how I feel about slots. Slots are a limitation on capacity which in a deregulated, free-enterprize system put an imbalance between supply and demand.

Every airport is a little bit different. We have got more capacity at Washington National and could increase the number of slots if we could get political support to do that. In the case of O'Hare, we are looking at ways to achieve some kind of continuity and on-time performance with the existing slot level. So it varies from airport to airport.

I wish we could have enough capacity, and part of the capacity enhancement benefits of the Reauthorization Act will help us a long way to deal with it. If we had a third airport in Chicago, we might not have to have slots at O'Hare. Slots are the only way we have currently to regulate the demand at certain high-volume airports. We have fewer slots in this country than they do in Europe, than they do in Japan, and in other parts of the world where there is a lot of air travel.

Four airports with slots are too many, but that is a lot fewer than any other country has, and we are doing everything we can to make it as fair as possible.

Senator EXON. These airlines that are going out of business, let us take Eastern for an example. Do you have the figures as to their total net worth? How much of their total net worth was valued in slot control that they had?

Secretary SKINNER. No, I think a good portion of their asset value was in the airplanes they owned, and the gates, or the long-term leases on gates that they had. At the third level, their maintenance spaces and probably, in listing of order of assets, the fourth most important asset was the slots. They did have some value, but I do not think it was as much as the other three. But we will get you that exact amount.

[The following information was subsequently received for the record:]

In the case of Eastern Airlines, slots represented less than 8 percent of its asset base.

Senator EXON. Well, I am wondering is it 25 percent of their net worth, negative net worth, or whatever?

Secretary SKINNER. We think it is about $75 million at one time on a total asset value of well over $1 billion. I do not think it was significant.

Senator EXON. But it certainly is a very attractive cash asset that they can sell off.

Secretary SKINNER. They have and did. And after 2 years in bankruptcy where the secured and unsecured creditors funded the airline with almost $1 billion, one of the ways that those secured creditors and unsecured creditors can recover some of the value is through an approximately $75 million worth of slots. But slots are not a major part of any airline's assets.

Senator EXON. Going back to 1978, and having seen the difficulty that deregulation has caused, and probably some pluses in some certain areas, on balance, if looking back at 1978, do you think we made a wise decision at that time with deregulation, or was it unwise?

Secretary SKINNER. Well, not only do I think it was a wise decision, people like the Brookings Institution and others, including most of the analysts that were in my office last Wednesday, all believe that it was the right decision because the consumer is benefiting on a real dollar basis, on an adjusted-for-inflation basis. And 65 percent more people are flying. And whether it is $159 or $300 from here to Florida, we have people using the system today that in the regulated environment would not. And the estimates are in multiples of billions of dollars of savings to the consumer over a regulated environment.

Senator EXON. So what you are saying, Mr. Skinner, and what all of these experts are saying that just because a consumer can fly to Florida and back today for $150 as opposed to $350 before deregulation, that that makes deregulation a good idea?

Secretary SKINNER. Well, the ultimate question to be answered is, "Did the consumer benefit?" Number two, "Are we competitive as a result of deregulation in the world?" And Senator, if I might, there is a reason that all the major countries in the world and the EC are now looking at ways to deregulate their industry. The biggest single movement in aviation in the European Community is to move towards deregulation. So I think other countries in the world have looked at what we have achieved for our consumer and what we have achieved in productivity, and they are now trying to achieve those benefits for their consumers and their citizens.

Senator EXON. Mr. Secretary, let us assume that when we only have three major airlines left in this country, and I suspect under that scenario, under any reasonable scenario, we could expect that the fares would go up considerably, I do not know how much. But if they went up more than the $350 that it used to cost to go from Washington to Miami or higher, would you still maintain that was a good bill that we passed at that time?

Secretary SKINNER. Well, first of all, Senator, I think that we are going to have more than three carriers. So I am not ready to assume that. Although, even if in a worst case we had three, I believe three could be very competitive. And the industry analysts who were in last week, who have no attachment to the Department—professors and economists from all over the United States—they believe that we will have more than three, that they will be competitive, and that prices will go up.

First of all, if no airline is covering its operating costs, they are going to have to raise prices. That is what the free market is all about. They are going to have to get their product priced at a sufficient level to cover their operating costs, to pay their debt, and to give a reasonable return to equity investors. And I think that is the process that we are going through.

I think in addition they have got to handle their increase in labor costs and other costs that they are incurring as a result of new contracts they are negotiating. So we are going to have an increase in airfares. It is not because of deregulation, it is because the airlines are not covering their costs.

I do not believe we will find ourselves in the situation, to answer your question, where we will have carriers who will be so non-competitive that they will be pricing their product at exorbitant price-gouging levels.

Senator EXON. I hope you are right, Mr. Secretary, but I am very fearful that you are not. And I frankly believe that what we have been going through here over the last few years of wholesale price cutting is just a prelude to three major carriers left in the United States. And I cannot believe how you can seriously believe that if we have only three carriers left that we are going to have competition. I just do not think that is going to happen. I hope it does, but I do not think it will.

Secretary SKINNER. Well let me say that at one time, and this will allow me to make another point if I might, at one time we had well over 100 automobile companies in this country, and that we now are down to three major companies that compete very effectively with each other. I might also add as a postscript, that as a result of some foreign competition, those companies have more competition then they have had before, and jobs have been created in states like Kentucky and others where there has even been more competition.

So one could argue that if you do not get enough competition with three, there are other alternatives to get more competition. I am not suggesting that to the Committee, I am just using that as the parallel—that industry has been through its transition. This industry is going through its.

Senator EXON. I am not sure you could compare the airline industry with the automobile industry, but it is an interesting comparison. On last question. Maybe to control some of these costs, what would you think of a proposition to where anytime one carrier obtained more than 50 percent of the market in a given area such as Washington, DC, or New York, or Lincoln, NE, or Chicago, IL, that under those types of scenarios, they would come back under some type of control and have to appeal to the Department through the old processes before they could change rates?

Secretary SKINNER. Well, I would object to that. I do not believe any major market that can justify two carriers will not have two or more carriers. I believe there are a lot of markets in which we will have two to three, sometimes even four, carriers in a very competitive mode.

And I would add on pricing, the problem the airline industry has is not charging excessively. They are having problems pricing their product to cover their operating costs.

Senator EXON. Whose fault is that?

Secretary SKINNER. Well, it is not deregulation's. It is the fact that we have a competitive system where they are fighting for market share. I have never seen an industry that fights harder for market share than the airline industry. And of course, the consumer benefits. It is going to have to return to some balance, but I do not think we run the risk of going from where we are to where we are skewed so badly that we will have no competition.

Senator EXON. Thank you, Mr. Chairman. And thank you, Mr. Secretary.

Senator FORD. Let me say that when someone wants to invest $2 billion in my State, hire 95 percent Kentuckians and the American worker produces a better product than they can produce, we will let them come on.

Senator Bryan?

Secretary SKINNER. That is free enterprise in the American system. I agree with you wholeheartedly, Senator.

Senator FORD. Well, you and I do not quite agree.

Secretary SKINNER. But it sounds like we do on that.

Senator FORD. Senator Bryan?

Senator BRYAN. Mr. Chairman, just a couple of observations before I ask the Secretary a couple of questions.

I was particularly struck by your explanation of why American Airlines, United, and Delta are healthy carriers. You said in part it was because they did not get involved in all of these leveraged buy-outs and these rather exotic financial risk structuring arrangements of the 1980's.

It strikes me first that it really is an indictment of the Federal regulatory policy of the previous decade. And also it seems to me it makes a very strong argument for enhanced authority being vested in your Department to review those major restructurings so that we do not have some of the chaos that we have had in the industry in the past decade and that we continue to have today.

Second, is a concern that it strikes me as well that our focus, as we discuss this, is very short-term. You have argued here in response to a number of my colleague's questions that the consumer has benefited, that fares have gone down greatly. And there is, it seems to me, a parallel with the argument that was made in the 1980's when the Japanese were dumping their chips, semi-conductors, in the market below cost that the consumer benefited.

Ultimately, the American consumer has been placed at a disadvantage because that drove a number of companies out of business, the Japanese dominated a segment of that market and drove the prices up.

So my questions really are focused on the long-term perspective. My first question is dealing with reciprocity.

In permitting foreign carriers to invest in domestic carriers, does the Department have a rule that is a condition precedent to any such investment that they must be satisfied that there is a reciprocal right on the part of domestic carrier to do the same?

Secretary SKINNER. Yes.

Senator BRYAN. So that is part of the policy?

Secretary SKINNER. And the KLM investment comes from a country and an airline that has a deregulated open market. And we have great access to that market.

Senator BRYAN. Are you satisfied that you presently have sufficient authority to guarantee that, indeed, if that carrier which is subjected to the foreign investment, that if there is a need for national security purposes, the situation we face in the Gulf today, that there is the authority that that fleet could be made available to support any foreign policy or military objective which is an overriding concern of the Federal Government?

Secretary SKINNER. Yes, we are. And I might add that that is something we have, obviously, looked at very carefully over the last several months.

One of the reasons, not the controlling reason, but one of the reasons that there was some sense of urgency on some of these transactions is that many of these airlines have airplanes that are in the CRAF fleet.

We have not had to go to Level 3 CRAF, we have been able to stay at level 2 and develop an effective delivery system. The U.S. flag carriers, I might add, have done a tremendous job of supporting Desert Shield and now Desert Storm.

Senator BRYAN. Let me ask you this hypothetical.

Assume, for the sake of argument, that you permit a foreign investment in a domestic carrier, that it complies with the guidelines that you now have in effect and the one that you recently indicated in terms of the modifications on the KLM, assume for purposes of argument that there is a need for a part of that domestic fleet for a national security purpose. Assume further that the board of directors of that airline declines to make that available.

Do you have sufficient authority, do we have sufficient authority to compel that part of that fleet?

Secretary SKINNER. Do you mean if a U.S.-controlled board of directors fails to make those aircraft available? We do have mechanisms to take aircraft over and crew them as necessary. In fact, at one time we considered taking over the airplanes if a carrier went Chapter 7 and crewing them with airline pilots that had been called from the reserves to active duty.

Senator BRYAN. I believe most of us have the experience that in business decisions one acts out of self interest, that part of the motivation is to make a profit. There is nothing wrong per se with that.

What do you think the motivation is of these foreign carriers to invest in domestic carriers when the track record has been, at least recently, a financial disaster for them?

Secretary SKINNER. Well, at this particular time in the industry, over the last several months, there haven't been a whole lot of new requests for investment by foreign carriers before the Department. I think there may be some this year, but later on this year.

They believe, as I do, that the aviation market of the future is global in nature, that there will be synergies between carriers on both sides of the ocean, whether it be the Pacific Ocean or the Atlantic Ocean. They believe that the companies that compete successfully in the world will be multi-national.

They want to participate in it. And they recognize there are opportunities on both sides of the ocean.

And as a result of that, they feel that in order to be a participant in the new airline industry, you will have to become a global player if you are a relatively small airline in other parts of the world.

They also believe that there are some opportunities because of a desire, by some of the airlines to become global who cannot afford to expand their networks through capital, to develop a synergy so that "carriers one through three" can go to" carriers one through six," or "one through seven." We might even have people interested in investing in carriers that traditionally have not sought foreign relationships.

Senator BRYAN. Is there a risk, Mr. Secretary, that even though the 25 percent threshold is observed that that might nevertheless constitute effective control?

Secretary SKINNER. Yes, there is, Senator. And that is why we were very cautious in the Northwest/KLM transaction until we saw a year and a half's worth of track record by the U.S. owners to see what kind of control they really had.

Once we were satisfied that they really were in control, we felt more comfortable relaxing the foreign investment rule.

Senator BRYAN. My question is aimed at the principle, rather than a specific transaction.

Assuming, as you said, that there is always that risk that 25 percent may, point of fact, constitute effective control, is there a concern that, indeed, with respect to some of these investments that there may be a diversion in terms of routing into the foreign carrier for international travel that may be to the disadvantage of the domestic market, may even be to the disadvantage of the carrier in which the investment is made? Is that not a possibility?

Secretary SKINNER. In structuring the transaction, we tried to structure it in such a way that the foreign directors or directors representing the foreign interest do not get themselves into anti-competitive or possible market allocation decisions. We have ways of doing that, the proverbial Chinese Wall. And we try to do that whenever we can.

Senator BRYAN. Let me ask you what kind of control you have after the fact. You have made all the threshold determinations, all the criteria from your perspective have been adhered to, and let us suppose that there is a foreign carrier invested in a domestic and that domestic carrier has a route from, let us say, Pittsburgh to New York. The foreign carrier is primarily interested in, say, the New York to Frankfurt.

So a passenger buys a ticket in Pittsburgh to get to Frankfurt and the passenger pays a total price. That is what the passenger is looking at. And it is a very competitive practice in terms of the passenger buying, whatever he can get that ticket price for.

Is there not a concern that, indeed, in allocating the revenue portion of the total ticket that if you have a foreign carrier that has invested in a domestic carrier, and indeed, there is control beyond that which you are able to ascertain at the point that you approve it, that in the allocation of that revenue, in effect, the domestic carrier may have a hollowing out of the revenue base?

And if that occurs, what authority, if any, do you have to say wait a minute, when we approved this thing, we never contemplated that. We had every assurance it would not.

Can you unwind the transaction? Can you impose sanctions? What can you do?

Secretary SKINNER. Number one, we do have an ongoing test of citizenship and control. In the case of Northwest, for instance, they periodically report to us.

Number two, your hypothetical would assume that the directors would be breaching their fiduciary duty to the shareholders as a result of an unfair and inappropriate allocation of cost and fare structures between those two airlines.

We think we have enough mechanisms built into the system to deal with that. We also have a lot of confidence that the initial system is set up in such a way that we will not have that situation.

Senator BRYAN. But would you have, and this is my last question, Mr. Chairman. I appreciate your time.

Would there be the authority on the part of your Department or any regulatory agency in Government to intervene and say, look, this practice is occurring, it constitutes a threat to the financial stability of that domestic carrier? Or is it just based upon your expectation that, indeed, the directors, because of their citizenship, will protect the interest of that domestic carrier? Some of these directors may be chameleon-hued fellows, not quite sure what loyalties they may have.

Secretary SKINNER. We tried to design systems that insulate the decisions from that type of influence.

And, we have an ongoing review. And at any time we can issue an order to show cause why the certificate should not be removed for failure to adhere to the control/citizenship test.

Senator BRYAN. But specifically, with respect to if you found out there was a hollowing out of the revenue base of that domestic carrier, would that be a factor?

Secretary SKINNER. That would be a factor in determining whether or not we would issue an order to show cause why the certificate should not be revoked. That would be one of the indicia of foreign control that we would take into consideration. Whether it would be compelling in and of itself depends on the transaction.

Senator BRYAN. Mr. Chairman, I thank you.

Senator FORD. Senator Danforth?

Senator DANFORTH. Mr. Secretary, you commented earlier that the challenge for the Department of Transportation is to try to make sure that there are as many competitive airlines as possible.

In the case of a very weak airline, one that is just skirting the fringes of bankruptcy, trying to keep alive, I take it that the need of that airline is for capital. Is that right?

Secretary SKINNER. Cash. The absolute, critical need for airlines today is to have cash, cash to keep operating during this difficult time. And many of the decisions that are being made today are being made for cash, to generate cash now. Whether it be America West's offer of a few days ago, whether they be offers that have been made in the past, they have to have cash to pay their bills.

If they cannot pay their payroll and they cannot pay their leases, if they do not have enough cash they cannot even operate in Chapter 11 because if you do not have enough cash you cannot operate in Chapter 11 without an additional influx of cash.

Senator DANFORTH. Okay. Now, one way to get cash is to sell assets.

Secretary SKINNER. That is just about the only way unless you have some assets that are unpledged so you can go to a bank and get an extension of credit based on a pledge of assets. And most of the carriers you are talking about have already pledged everything and the banks for some reason have loaned them this level of capital.

Senator DANFORTH. Let me see if I follow your reasoning.

Am I correct in understanding you to say in effect that the airlines need cash, the big weak ones, without which there would be maybe three remaining competitors? One way to get cash is to start selling off pieces: selling off routes, selling off slots, selling off aircraft.

Another way to get cash is to find somebody who wants to come in and invest; is that right?

Secretary SKINNER. That is correct.

Senator DANFORTH. Your theory, as I understand it, is that by opening up foreign investment for U.S. airlines, that would be an alternative for the weaker airlines to follow in addition to the alternative of just selling off the pieces and, as Senator McCain said earlier, becoming a corpse with a feeding system?

Secretary SKINNER. It is not just my idea. It was suggested by the industry when they appeared before me when we met during the early stages of Desert Shield. I asked them what I could do, and they made a number of suggestions. One of the suggestions they said was, consistent with law as it relates to ownership and control, if you can help us attract foreign capital, it will allow us to generate cash and capital to get through this very difficult situation. It was on their suggestion that we made this decision.

Senator DANFORTH. Is it fair to say that in some way modifying—whether you did it on January 23 sufficiently is my next question—the foreign ownership rule or reinterpreting the foreign ownership rule really is the alternative to the sale of pieces? Is that a fair statement?

Secretary SKINNER. Absent a pledge, if there are assets, there are three real alternatives——

Senator DANFORTH. But let us say the weaklings have pledged all their assets, they are struggling along, they have scraped together as much as they can. Now the situation they are in is they are just teetering on the brink.

I think what you are saying is that they have two possibilities. One is they sell the route, whether it is from Chicago to London or whatever else they can sell or the slots or whatever pieces they can sell, obviously selling off or oftentimes, I suppose, selling off their more profitable assets because those are the ones for which they can get the cash.

The other possibility is to open up foreign ownership.

Secretary SKINNER. That is correct.

Senator DANFORTH. Let me ask you this. You just made the decision 3 weeks ago in your speech and issued your interpretation of January 23. Have there been any nibbles on that, to your knowledge, or is it too early to decide whether or not there is a favorable response to your reinterpretation of the foreign ownership rule?

Secretary SKINNER. I have been told that a number of carriers who fit into the latter category have had some expressions of interest and have begun negotiations with various carriers. They are being told, among other things, that we did not go far enough and that we ought to go further and that the Congress and the administration ought to take the position that we ought to expand the ability to invest still consistent with U.S. control. That is what, I might add, the Clinger bill in the House calls for.

This administration has not yet made a decision on that, but when I met last week with the analysts who look at this from an esoteric, scholarly viewpoint, not that I do not—they told me that we should consider going even further. I was reluctant to go further without consultation with and authority from the Congress.

Senator DANFORTH. The one conversation I had with somebody who knows something about foreign airlines was to the effect that this reinterpretation really did not go far enough, that the 25 percent/49 percent rule was not very attractive from the standpoint of a foreign airline.

I take it, therefore, that if it is not sufficiently attractive, the only option that an airline like TWA would have would just be to keep selling off pieces.

Secretary SKINNER. Right.

Senator DANFORTH. What is going to happen to TWA?

Secretary SKINNER. I think TWA is going to have to, it would appear, restructure its debt in the short term, and that is what this process is all about. Rather than filing for Chapter 11, Mr. Icahn would default on all his debt with the idea that because it is a privately-held corporation he can renegotiate this debt at a level that he can live with, maybe deferring interest and some principal payments.

If he is not, I would assume that he will have to make other decisions.

The problem that carriers like TWA and Pan Am face right now, Senator, is that traffic between the United States and Europe has dropped off as much as 40 and 50 percent; therefore, their revenue base, their cash flow in the low period is off substantially.

As part of this process, we have to convince the American people that it is safe to fly, which it is, that the system is safer than it has ever been, that they are

not at risk, and we should return to normal as the President and others have asked us to. If we can get the American people and the Europeans, but primarily the American people, out of the mind set of not traveling, we can do an awful lot to alleviate that problem. Unfortunately, so far we have not been successful in doing so.

When you have 400-seat aircraft, flying with 28 people, it just exacerbates the problem.

Senator DANFORTH. If you were not only scholarly and esoteric but also a bookie——

Senator FORD. You sure summed him up, there.

Senator DANFORTH. ——what would you put the odds of TWA's survival for more than 6 months as being?

Secretary SKINNER. I have not really focused on it because the lawyers in the Department will not let me make that kind of bet.

We are doing everything we can to help TWA and other carriers through this very difficult time. If TWA does not survive as a stand-alone carrier, there are many people who believe it will be part of a consolidation of a much bigger structure. They also believe that areas like St. Louis will continue to be served as a very important market in this country and that many of the employees, if there were such a merger between airlines, would continue to be employed in a new route structure.

Senator DANFORTH. You know so much more about antitrust law than I will ever know. Do you think that the analogy between three strong airlines and three strong domestic auto companies is a good analogy or a bad analogy?

Secretary SKINNER. You have to look at their structure. You have to look at what markets they are serving.

Senator DANFORTH. That is right. What is the relevant market?

Do you think it is a good analogy or a bad analogy to say that in the case of, to take a city, St. Louis having three remaining airlines, United, American and Delta, is analogous to having three car dealers or three companies that are represented by car dealers in your community where you can go and buy and car?

Secretary SKINNER. If you make one assumption, which I have made in all my pronouncements, that those carriers will expand and serve markets like St. Louis. In Chicago, the two major competitors at O'Hare are United and American, and they fight for market share like cats and dogs. I believe that the same conditions will exist in other markets like St. Louis.

Senator DANFORTH. In other words, you think that in a market like St. Louis, instead of having one airline that has 82 percent of the passenger traffic, there would be three airlines that would be competing, say, between St. Louis and Washington or St. Louis and New York, and a passenger could go in and say, well, look, instead of Airline A today to New York I will get a better deal on Airline B? Do you believe that is going to be the case?

Secretary SKINNER. Yes. The analysts and the economists who were in last week obviously say that three is better than two, but two in a market can provide some very effective competition.

Senator DANFORTH. Do you think there would be two or more in St. Louis that would be competing for the passengers' dollars?

Secretary SKINNER. I have not looked at the market in detail enough to say whether it would be three. I think it is at least a two-airline market for sure.

Senator DANFORTH. What should we—you, me, all of us—do to attract another airline to—and I do not want to just talk about St. Louis—any city that is dominated by one airline? What should we do to attract another airline?

Secretary SKINNER. First of all, let us take an example right now in Atlanta, because we have a void that was left with Eastern in Atlanta. Northwest very much wants to go into Atlanta. They have to look at how they get in there.

The things that will determine how they get in there are:

Number one, the amount of access they have to the airport, air space and landing slots. In the case of Atlanta, we have no air space or landing slot problems;

Number two, gates. Do they have access to gates? Delta has almost all of concourses A and B in Atlanta and has a dominant position in gate structure. The city fathers who control the gates have got to make enough gates available at reasonable prices to recruit a second carrier there. They must recognize it is in their best interest, and those discussions are ongoing.

Number three, we have to do things that are procompetitive in nature to deal with the anticompetitive decisions that are sometimes made by airport authorities and airlines regarding long-term leases on gates, and we are dealing with that issue. As I said, we are expanding the system through passenger facility charges and "growing" the FAA from $5 billion to $9 billion within 5 years.

If we spend that money, get away from long-term leases, and expand capacity, airlines will be encouraged to go into those facilities. Those are the kinds of things we can do.

Senator DANFORTH. Thank you, Mr. Chairman.

Senator FORD. Senator Bentsen.

Senator BENTSEN. Thank you very much, Mr. Chairman.

When you talked about the foreign airlines moving away from regulation and subsidy, I hope you are right, Mr. Secretary. But we have just been through 4 years of negotiation on GATT trying to break into the markets of Europe on agriculture, and we have made no headway at all. We saw them last year spend $12 billion on export subsidies on agriculture.

What you are seeing when they purchase here, is just what you said, trying to get market share. Hopefully with the idea of buying a minority interest and as time goes on that attitudes and laws will change and they can own an airline here, I believe. So they will take their losses for a while for that kind of long-term prospect.

I look at Senator Danforth's comments about St. Louis and TWA and well understand them. He does have a responsibility to represent his constituents. And so do I. I have three major airlines—well, really two and one regional. One of them has been in and out of bankruptcy and that is Continental The other is American, which is strong financially. I have a third, small—not so small—regional airline in Southwest. It has an incredible rapport with its passengers. The other day I got on in Austin, the steward as he is getting ready to take drink orders on a flight to Dallas said, this is a short flight. If you cannot chug-a-lug it, do not order it.

Then when we landed in Dallas, in kind of a controlled crash, the pilot got on the line and said you know we had just been shot down. But he said it was the copilot that screwed up. With that kind of relationship, they will probably survive whatever comes.

But I am concerned about the viability of the airlines in my state, too, that provide so many jobs. I am looking at United's pending purchase of Pan Am routes, many of its routes. And then I am looking at the proposed purchase by American of TWA. And my deep concern is that we use the same standards in evaluating them and that we come to a conclusion as to whatever it is at approximately the same time on the two. I do not think they are that different.

My concern is just what you were saying earlier when you said United and American fight like cats and dogs for market share. If United gets its award, a decision that is favorable and develops market share, that is a difficult thing to overcome once one has had it for many months. So I would hope the decision will be forthcoming in a very, relatively short period of time between the two of them, if not at the same time. That is my concern.

Secretary SKINNER. Can I address that if I might, Senator? First of all, I think that in addition to Continental, Southwest, and American that are all headquartered in your state, you also have Delta at Dallas-Fort Worth, which is a very good competitor to American.

Number two, the request by United was the first one before the Department. There were fewer objections, and it was less complicated and a decision was made while at the same time we negotiated with the UK for access for two carriers.

Senator BENTSEN. Well, then you did not have the eloquence of my friend, Senator Danforth, on that one, too.

Secretary SKINNER. No—and you are no slouch yourself, sir.

There have been negotiations ongoing to substitute new carriers at Heathrow. It has not been going as well as we would like. United is not able to fly until that substitution occurs. I believe that as we negotiate that substitution, if we are successful as I hope we will be—I am not overly optimistic right now, but I am hopeful that we will kind of step back and then move forward — that the transaction involving American will be resolved with a decision in time, so that if American is going to be the carrier to succeed TWA, everything will be in place for those two substitutions to occur simultaneously.

It is not our intention to deprive either airline of a fair and level opportunity to compete. And I have no reason to believe, based upon how I see things moving, that that will be a problem.

Senator BENTSEN. On the international interest in investments, a part of the GATT negotiations, of course, have been investments—and one of those things that have been zealously guarded by many of the countries is transportation, keeping out the foreign investments on transportation. I would strongly hope, because at times I think we have been badly out traded when it comes to routes. I would strongly hope that in the liberalization of investment in this country in transportation, that we get in these bilateral agreements something comparable in the other country to the degree we can.

Secretary SKINNER. Well, Senator, I have been deeply involved in negotiating, along with the State Department, bilaterals since I have been secretary, and I think we have been out-negotiated in the past. One of the reasons is that the negotiators on the other side have a longer vision than we do. And we are typically looking for a short-term fix. And then we do not understand the long-term attitude of others.

I have taken, I think the industry will tell you, a stronger position on these issues than any Secretary in history. For instance, regarding the negotiations in Japan on slots, I thought that when I negotiated for routes and approved the transaction and awarded routes, as did the Japanese, that we were also talking about equal access to the market at slot-controlled airports. We readily gave JAL and All Nippon Airways slots at Chicago as part of that agreement. And then we found ourselves in a very difficult situation in Norita, which is a slot controlled airport.

I do not understand why they took that position. But when the Japanese took the position that they negotiated for routes, not slots, then we told them that we were not going to allow the Japanese carriers to come into this market until we

had access in that market. And those negotiations are proceeding along. And I am optimistic that this week we will reach a point that everybody can fly as was intended.

In the case of the British carrier, which is actively involved in service to Europe and London, it wanted me to make some rate decisions which had long-range implications for fare structures through the rest of this year. Yet I do not even know which U.S. carriers are going to be serving that market from our side, so for me to make a decision based upon assumptions which I do not know will be correct, in my opinion was not warranted. So I took the position we could approve it for a shorter period of time, and then we will see what progress we make on getting some substitution at Heathrow.

We have taken our negotiations positions on a very active and very vigorous basis. The problem is that, in the past sometimes we were out-negotiated, and as a result of that, I have now got to repair that "out-negotiation." I do not want to give the store away. There is a certain price we will pay for the transfer at Heathrow. What we put on the table is more generous than many people would prefer. But we cannot go much further than that, and if they are asking for more than that, we are going to be at real loggerheads.

And even though American might be the beneficiary if a decision is made, you would not want me to give away position on this, to give away something that is just beyond the sale nor would the carriers involved.

Senator BENTSEN. I sure would not. That is correct. I feel real strongly about that.

Secretary SKINNER. We believe that we can go no further, and I am optimistic that we will work that out. And everything will come together at some point.

Senator BENTSEN. Thank you very much, Mr. Secretary. Thank you, Mr. Chairman.

Senator FORD. Thank you. Senator Gorton?

Senator GORTON. Mr. Secretary, there has been a great deal of talk about three surviving airlines, or perhaps four surviving airlines, and a great deal of apprehension about a number that small and an obvious desire here in the Committee, and I suspect in your office, to see to it that there are a larger number of airlines than either of those two digits if it is at all possible.

What policy prescriptions would you recommend to the Congress of the United States that it could carry out. And what policy recommendations are you considering within the frame of reference of your own authority which will or would enhance the strengthening and retention of more than three or four major airlines in the United States for competitive purposes?

Secretary SKINNER. Well, let me see if I could name several things that we are doing, and then let me address the Congressional issue second, if I may.

Number one, you are right. The number that is in my mind is more than four. Number two, we are convinced that the decisions we make during this consolidation period can determine whether there will be more than four or not. Number three, just as in the Northwest transaction last week, when we worked very closely with the Justice Department, we acted to ensure that Northwest can be one of those carriers. They need a viable presence in the East to build up their network. It would be pro-competitive for Northwest to be the carrier serving National rather than United, which already serves the Washington area at Dulles. And therefore, we and the Justice Department were very encouraged with the outcome at that transaction in bankruptcy court.

In the awarding of international routes new bilateral negotiations, we take into consideration whether or not we can help an airline, one of those not in the big three, fly an international route. We have also taken steps to increase the

opportunities to attract foreign capital and to develop synergies between U.S. and foreign flag carriers consistent with Federal law.

All of those things, I think, are things that go through our mind every day. I believe, as Senator Danforth has mentioned, that it is time for the Congress of the United States, just as it is time for this administration and this secretary, to consider whether or not we should relax foreign even further, as suggested by many analysts and others who have no vested interest, the foreign investment requirements of the law, still maintaining control with U.S. citizens. Maybe taking it to 49 percent from 25 percent might very well attract some additional capital, as Senator Danforth has suggested.

These airlines, to survive, as Senator Danforth pointed out, have to have capital—cash now and capital later. They have got to find ways to attract cash now and capital later. We can only do so much, then they have got to have a viable network. We are trying to give them something that they can use to attract capital both domestically and foreign.

Senator GORTON. Should we be considering requiring the making of the availability of slots or landing space or gates at say the 20 largest airports in the United States for newcomers on a relatively unrestricted basis?

Secretary SKINNER. Well, the problem right now is being dealt with in a slot rule that is pending before the Department, which I think will be out within the next 30 days, which will allow new entrants to have an opportunity to participate in these slot transactions. There is real interest right now, from what I would call new entrant-type carriers, such as America West and Midwest Express, and we believe the new rule coming out, consistent with the requirements of the Reauthorization Act will enhance the ability of those two carriers, and others to participate in slot transactions on a reasonable basis.

Senator GORTON. On the subject that you were discussing with Senator Bentson, my understanding of your answer was that you felt that in some respects we had been too generous in these reciprocal rights in the past and that you have gone about as far as you feel our government reasonably can go with respect to additional rates for United Kingdom Airlines, in exchange for the transfer to American and United.

Is it not true, however, that the British authorities can effectively put Pan American and TWA out of business simply by delaying a decision in connection with these changes? And if in fact that should happen, if they should be required to abandon those routes or cut down on those routes, have you been considering any reciprocal action that would cut down the access of the airlines for which the British are fronting here in the United States?

Is there any downside, in other words, to the British in not reaching a reasonable agreement with us in a reasonable time?

Secretary SKINNER. Well, I think the situation where two U.S. flag carriers that have served that market so well are no longer in business, yet the replacement U.S. flag carriers do not have complete access to the most desirable airport in the U.K., I think that scenario is unacceptable.

It is certainly unacceptable to me, and I do not think in the long run it is really what the U.K. authorities have in mind. That would be, in my opinion, penny-wise and pound-foolish, no pun intended.

It would appear to me that what we have to do is reach that balance that makes sense on how Heathrow access is valued. I would argue that if those carriers no longer operated, the "corporate successor" provision in the agreement would clearly be triggered that we would just award the route to someone else and tell them to start flying it and see what happens.

I hope we never arrive at that, but if they are in fact the "corporate successor" and there is no former airline left, it was never intended that no one would take their place and fill that void.

Senator GORTON. Well, you have about three-quarters answered my question.

Secretary SKINNER. The other quarter we will save in the back pocket, hoping we will never have to use it.

Senator GORTON. Do you have the authority to restrict access of a foreign airline here in the United States, if in effect you are restricted there?

Secretary SKINNER. I think it would involve a renunciation of the bilateral, which I would like to avoid. It is very complicated and messy. The media has made a little bit more of this than they should. There is a real difference of opinion as to what this access is worth.

Number one, we gave up some access in an earlier bilateral primarily in return for allowing a second carrier to serve from Boston. Now we are well beyond that, into a much higher level of concessions. I am hopeful we will work something out.

Senator GORTON. Thank you, Mr. Chairman, a very interesting first meeting of the subcommittee for this Senator.

Senator FORD. Mr. Secretary, you are not through yet. I just have two quickies for you. Would you consider a rulemaking on foreign investments?

Secretary SKINNER. I think we have the ability to change criteria in an individual transaction, and I think to get into a rulemaking probably is not necessary, because we have the flexibility and we have gone about as far as we go looking at these individual transactions. If you gave me the authority to do a rulemaking, to take it up to 49 percent, I am sure we would seriously look at it.

Senator FORD. Well, you have already done that.

Secretary SKINNER. That is on total equity, not on voting equity.

Senator FORD. Yes, but it seems to me, as I said in my opening statement here, that if you go case by case, there is nothing to gauge by, there is no watershed decision. A rulemaking might be important. I think you have the authority to do that now without our giving it to you.

The final question then, I was not privileged to go to the Press Club to hear your eloquence when you made a big statement there not too long ago, but I did receive a copy of your speech and I read it and you said that one of the major problems of airlines is the high pay to employees.

Did you say that in the speech, and if so, do you really mean it?

Secretary SKINNER. I believe the airlines have a real problem in controlling costs. If they are not able to control costs across the board, they are not going to be able to survive. I raised the question as to whether or not, in these difficult times, wage increases to any group of employees that substantially exceed the cost of inflation after productivity adjustments, are in the long-run best interest of the industry.

I have raised that question. Many airline and other experts who are involved in the labor field share that concern. It was not my intention to point out anything other than, if you do not control your costs, they are passed on to the consumer, and if you let your costs run up at a greater rate than inflation, the consumer is the one that ultimately pays. The airlines are having a very difficult time controlling their costs.

Senator FORD. They may be, but it is my understanding, that the three most financially stable airlines, pay the highest salary.

That is my understanding, that those three airlines are the ones that pay the higher wages.

Secretary SKINNER. I would only make two observations on that: those three airlines do not have a restructured capital structure, and I suggest those three airlines would be in the same shape as the others if they had restructured at a very high and excessive debt level.

And number two, Mr. Beauvais can answer the question better than I can. He negotiates in a very effective way for wages and he has an employee ownership concept at this airline that, I think, is frankly an example of what is going to exist in the future.

It is a challenge. We all have challenges in life, Senator, I suggest that the airline industry managers have that challenge and we will see how successful they are. But if they are not successful, the consumer is going to pay. Do not blame deregulation, blame the inability of managers to control their costs.

Senator FORD. One of the things that you have to think about is that these airlines staved off the leverage buy-out, they made the right financial decision, and therefore they are still there and they are still participating.

So I think you have to look at what those substantial airlines did and why they are substantial today and why they are competitive. When you start this leveraged buy-out and junk bonds and things of that nature, you look back on that as a very sad period.

Thank you, Mr. Secretary, it is always a pleasure to have you. We look forward to having you before us again.

Secretary SKINNER. Thank you. Not for awhile I hope.

Senator FORD. We always will guarantee a warm room.

Senator GORTON. And a warm welcome if nothing else.

Senator FORD. You notice all the transportation employees beginning to leave the room. The next witness will be Captain J. Randolph Babbitt, President of the Airline Pilots Association. He is our new Captain Duffy.

Captain Babbitt, it appears that Secretary took all of the international lawyers with him, too, so if you will wait just a minute for the room to come to order, we will let you testify. [Pause.]

Senator FORD. Captain Babbitt, we look forward to your testimony.

## STATEMENT OF J. RANDOLPH BABBITT, PRESIDENT, AIR LINE PILOTS ASSOCIATION; ACCOMPANIED BY RUSSELL BAILEY, COUNSEL; AND KENT SCOTT, CHAIRMAN, PILOTS MASTER EXECUTIVE COUNCIL, TRANS WORLD AIRLINES

Mr. BABBITT. Good morning, sir.

Good morning, Mr. Chairman and Members. I am Randolph Babbitt, President of the Air line Pilots Association. ALPA represents more than 42,000 pilots from 51 airlines. I am also testifying today in my capacity as Vice President of the Transportation Trades Department of the AFL-CIO, which is composed of 25 affiliated unions representing millions of transportation workers.

With me today on my left is Kent Scott, Chairman of the Pilots Master Executive Council at Trans World Airlines, and, on my right, Russell Bailey, an attorney with the Air Line Pilots Association.

The two issues before the subcommittee today, the transfer of international route certificate authorities and foreign investment in airlines, have captured the attention of the entire aviation industry. In particular, the proposed sale of large portions of Pan American's certificate authority for U.S. to Europe operations to United Airlines and the sale to TWA's European certificate authority to American Airlines could vastly alter the landscape of U.S. international operations.

With respect to foreign investment in U.S. airlines, last month the Department of Transportation's new interpretation substantially relaxed the conditions that it had previously placed on KLM's investment in Northwest and dramatically changed the effect of current law. ALPA believes that Congress should review events in both of these areas with the intent to provide additional guidance and standards.

Regarding international route rights, section 401(h) of the Federal Aviation Act prohibits any transfer of certificate authority unless the transfer is "consistent with the public interest". It is somewhat of a surprise, therefore, that the Department has never disapproved nor placed any significant condition on a route transfer reviewed under 401(h) since the expiration of section 408.

The DOT has also consistently refused to apply any sort of labor protection as a condition of approval, even though one of the statutory public interest factors in certificate transfer cases is the need to encourage fair wages and working conditions.

The DOT has also refused to require that a carrier selling route authority demonstrate how it will use the proceeds of the sale to enhance the economic viability of the carrier. TWA's sale of its Chicago-London route is a case in point, and now TWA is once again back before the DOT asking for permission to sell what by the carrier's own admission is the heart of its system, its U.S. to London route authority.

ALPA's financial review indicates that the sale of route authority in question will only accelerate TWA's financial losses and lead to the demise of that carrier.

Regarding foreign investment, ALPA fully recognizes that some of our airlines could well benefit from injections of foreign capital. However, foreign investment in and of itself is not going to be the cure-all for financially ailing airlines. There are many persuasive arguments as to why foreign control has been prohibited and why it should continue to be prohibited, some of which are contained in my written submission.

While there are many troubling aspects to the recent hasty DOT decision to permit KLM to acquire up to 49 percent of the equity of Northwest Airlines, let me focus on just two points. First, the DOT has removed the administrative oversight necessary to insure that the equity holding will not be used eventually to control Northwest in the future. Second, even more troubling than the result is the manner in which DOT's decision was reached.

My written submission to the subcommittee shows in detail how the DOT thwarted any meaningful participation in the review process by Congress or any other interested parties.

Let me just say here that it was an amazing example of how quickly the bureaucracy can move when it does not want a process to get too much sunshine.

With respect to what Congress might do to improve the process by which route transfers and foreign investments in U.S. carriers are reviewed, ALPA has several suggestions. First, Congress should amend section 401(h) to prohibit sales that clearly undermine the financial viability of an airline as determined by an objective financial review.

Second, Congress should require that any carrier that wishes to sell the rights that have been entrusted to it must first present a realistic plan of how it intends to use the proceeds of the sale to enhance its viability and its fitness.

Finally, with respect to route transfers, Congress should require that the acquiring carrier offer employment by seniority to the same number of employees used by the selling carrier to operate the route. Provisions should also be legislated for the fair and equitable integration of the transferred employees into the purchaser's work force.

With respect to foreign investment in U.S. carriers, the Federal Aviation Act should be amended to prohibit actual foreign control of any U.S. airline. U.S. carriers and their potential foreign investors should be required to file applications for approval for the proposed investment. Interested parties should then be afforded an opportunity to review and comment on the applications and public hearings held when appropriate. Congress should establish a set of factors to be considered by the DOT in deciding whether or not to improve the investment.

These factors are all summarized in my written submission.

I thank you for inviting ALPA to appear before the subcommittee today, and I would be happy to entertain any questions that you might have.

[The statements and questions and answers follow:]

STATEMENT OF CAPTAIN RANDOLPH BABBITT, PRESIDENT AIR LINE PILOTS ASSOCIATION, INTERNATIONAL AND VICE PRESIDENT, TRANSPORTATION TRADES DEPARTMENT, AFL-CIO

I am Randolph Babbitt, the President of the Air Line Pilots Association, International ("ALPA") ALPA, which represents over 42,000 pilots of 51 airlines, appreciates the opportunity to come before this Subcommittee today to present its views on transfers of international route certificate authority and on foreign investment in U.S. airlines. I am also testifying today in my capacity as the Vice President of the Transportation Trades Department of the AFL-CIO, which is composed of 25 affiliated unions representing millions of transportation workers.

It is quite appropriate that the Subcommittee hold this hearing. Both of the issues under review are commanding the attention of the entire airline industry. Major route transfers include the proposed sale of large portions of Pan American's and TWA's U.S. - Europe certificate authority to United and American, respectively. Other proposed sales raise the questions whether carriers should be permitted to sell authority awarded in a carrier selection case before that authority is operated, and whether a carrier that has ceased operations should be allowed to sell its route authority. With respect to the issue of foreign investment in U.S. airlines, several carriers recently have asked for a change of the rules governing such investment and last month the Department of Transportation substantially relaxed the conditions it had previously placed on KLM's investment in Northwest. In addressing both route transfer and foreign investment cases, DOT is confronted with difficult policy choices. ALPA believes that Congress should provide additional guidance and standards in both areas. Accordingly, after I address both topics generally, I will make some specific recommendations of actions ALPA believes Congress should take.

In discussing international route rights it is important to keep in mind exactly what these rights are. They are rights to operate foreign air transportation that are originally granted by foreign countries to the United States. U.S. airlines are then awarded these rights, frequently in carrier selection cases, after the government determines that public interest will be advanced by the awards. The cost to the carriers of obtaining the rights is usually nominal. Given the nature of international route rights it is not surprising that Congress has found it appropriate to legislate the terms under which they may be transferred. Section 401(h) of the Federal Aviation Act prohibits any transfer of certificate authority unless the transfer is "consistent with the public interest." In addition, that section was amended last year to require the Secretary of Transportation to certify to the appropriate Congressional committees that each certificate transfer is in the public interest and to accompany the certification with a report analyzing the effect of the transaction on (1) the viability of the carriers involved; (2) competition in the domestic airline industry; and (3) the trade position of the United States.

Prior to January 1, 1989, section 401(h) did not receive much attention because route transfers were usually part of larger acquisitions that were examined under former Section 408 of the Act. Since Section 408 expired, however, section 401(h) has moved to the forefront in route transfer cases and DOT has placed its own gloss on the section. The Department's general policy is to permit transfers "provided that they do not conflict with important aviation policy objectives and are not otherwise inconsistent with the public interest." The Department has also determined that the recent amendment to section 401(h) does not create a "new viability test" and that positive findings on the three newly added criteria in Section 401(h) are not prerequisites to approving particular transactions.

To ALPA's knowledge, the Department has neither disapproved nor placed any significant condition on a route transfer reviewed under 401(h) since Section 408 expired. In particular, DOT has consistently refused to apply any sort of labor protection as a condition of approval even though one of the statutory public interest factors that the Department must consider in certificate transfer cases is the "need to encourage fair wages and working conditions." Rather, the Department has decided that it will leave employees to try to obtain transfer related protection through collective bargaining, even where, as in the transfer of Eastern's South American routes to American Airlines (a transfer that represented more than 200 pilot jobs at Eastern), there is substantial evidence in the record before DOT that an airline has made a complete mockery of the collective bargaining process.

DOT has also refused to require that a carrier selling route authority demonstrate how it will use the proceeds of the sale to enhance the economic viability of the carrier. When TWA applied for permission to sell its Chicago-London route authority to American, ALPA and other parties argued that because the sale was a part of the dismantling of TWA and would undermine the future viability of the carrier DOT should have required the airline to produce a business plan as a prerequisite to any approval of the sale. DOT rejected ALPA's argument, concluding that the proceeds of the sale would enable TWA to "rationalize and strengthen its other operations and remain a competitive force in the remaining markets it serves." The principal problem with DOT' s conclusion is that there was nothing in the record of the case to support it. Now TWA is back before DOT asking for permission to sell what by the carrier's own admission is the heart of its system — its U.S. -London route authority. Again, the carrier has presented no plan how it would use the proceeds of the sale to maintain its competitive viability. ALPA believes that the sale of the route authority in question will accelerate TWA's financial losses and bring about the speedy demise of the carrier, but given DOT's apparent inability to say "no"' to carrier requests leaves us pessimistic about the outcome of the case and the fate of the airline.

As important as the question of the transfer of international route authority is, however, the question of whether or not greater foreign investment in U.S. carriers should be permitted is perhaps even more crucial.

The Federal Aviation Act prohibits foreign ownership of more than 25 percent of the voting stock of U.S. airlines and limits the number of board seats and management positions foreign citizens can hold. In addition, for over 50 years DOT and its predecessor, the Civil Aeronautics Board, have required that U.S. airlines actually be controlled by U.S. citizens. Neither the Act nor the administrative precedent is designed to prevent airlines from obtaining access to foreign capital markets and ALPA fully recognizes that some of our airlines could benefit from injections of foreign capital. We do question, however, whether foreign investment in and of itself is going to be the miracle cure for financially ailing airlines, and believe that there are several reasons why foreign control has been, and should continue to be, prohibited.

First, the Gulf war illustrates a very real need to protect national security interests. A large portion of the military goods and personnel transported to the Gulf are being carried by commercial airlines voluntarily provided by U.S. airlines under the Civil Reserve Air Fleet (CRAF). Foreign ownership raises serious questions about the continued availability of CRAF service.

Second, transportation is a vital sector of the U.S. economy, comprising almost 18 percent of GNP. The air transport industry is an integral part of the transportation system. If foreign control were permitted, valuable assets and resources could be diverted from U.S. to foreign airlines, potentially crippling our industry.

Third, and more broadly, the prospect of foreign ownership raises the haunting specter of other American industries that have shrunk or vanished from the scene because we sold or threw away our technological lead in those areas. The U.S. market is the largest aviation market in the free world and some U.S. carriers are the most competitive and efficient in the world. Does the United States really want to risk handing control of this key industry over to foreign interest?

Fourth, if the foreign investor is a foreign airline the investment may pose significant dangers for the competitiveness of the U.S. carrier. It seems to us that a controlling foreign carrier is highly unlikely to permit the U.S. carrier to compete in markets the foreign carriers serves.

Fifth, permitting control of U.S. airlines by foreign carriers may undermine the United States' ability to achieve its objectives through bilateral negotiations. If foreign carriers can obtain the routes and market access they desire by taking an ownership interest in a U.S. carrier they will not need to negotiate for their objectives through the bilateral process.

It is in this context that we look at the recent hasty DOT decision to permit KLM to acquire up to 49 percent of the equity of Northwest Airlines. The response by the Association of International Investment—which favors the lowering of foreign investment barriers—to Secretary Skinner's announcement of the decision sums up our view of this matter: "What foreign owner would put up 49 percent equity into a domestic airline without control?" The DOT is either naive or hypocritical if it thinks that a foreign investor is going to pour hundreds of millions of dollars into an airline without exercising control to protect its investment.

The ultimate contradiction in the DOT's decision in the Northwest/KLM case was not that it decided to raise the equity limit. Rather, it was that the DOT removed the administrative oversight that could have ensured that, now that the investment is actually in the hands of KLM, the equity holding could not be used to control Northwest in the future. According to the DOT the oversight and reporting requirements were no longer needed because there was no indication that KLM had been able to exert control over Northwest during the 15 months since DOT had first established the conditions under which KLM could hold its ownership stake. But, in ALPA's opinion, the lack of evidence of control simply showed that the conditions placed by DOT on KLM's investment may have worked. It does not, and cannot, in any logical way, support the conclusion that with the removal of the restrictions there will continue to be no control problem. This is particularly so given that KLM is being permitted to increase its equity stake in Northwest as well as its membership on the airlines board of directors.

ALPA is also concerned about the process by which DOT decides whether a particular foreign investment in an existing carrier will be permitted. Even more troubling than the substantive result in the Northwest/KLM case is the manner in which DOT's decision was reached. The Department's action there shows that it is prepared to try to thwart any meaningful participants in the reviewing process by Congress or any other interested parties. With DOT's special permission Northwest filed its petition for modification of the conditions placed on KLM's investment on January 15 after the DOT's docket was officially closed. To ALPA's knowledge, no outside person was served with the petition. The next morning DOT posted a notice that it would shorten the normal period for answering the petition to two days. Then, only five days later, on January 23, the Department issued its final order. The fact that the issuance of the order was timed to coincide with a speech Secretary Skinner was giving that day in which he announced that the Department was taking steps "to create an environment more receptive to foreign investment in the U.S. airline industry"' it almost appears that DOT may have invited Northwest to file its petition so that the Department would have a vehicle to demonstrate that the foreign investment restrictions were being relaxed in practice.

With respect to what Congress might do to improve the process by which route transfers and foreign investments in U.S. carriers are reviewed, ALPA has several suggestions.

First, Congress should amend Section 401(h) to prohibit sales that undermine the financial viability of an airline. Last year, Mr. Chairman, you and your colleagues on this subcommittee, Senators Danforth and McCain, introduced legislation that would have done just that. Unfortunately, that provision, section 708 of the Airport Capacity Act of 1990, was substantially diluted before it was enacted, and DOT has found that a positive finding on the effect of a route sale on a carrier's viability is not a prerequisite to approval of the sale. As I mentioned before, the current effort of TWA to sell its U.S.-London routes to American makes the need for an explicit prohibition of route sales that would undermine the viability of the carriers involved painfully clear.

Second, ALPA believes that Congress should require that any carrier that wishes to sell the rights that have been entrusted to it must first present a realistic plan of how it intends to use the proceeds of the sale to enhance its viability. Because route rights belong, ultimately, not to individual carriers but to the United States, any proceeds of their sale should be used to advance public, not private, interests.

Finally, with respect to route transfers, ALPA believes that Congress should require that the acquiring carrier offer employment to the number of employees used by the selling carrier to operate the route. The offers should be in seniority order and provisions for the fair integration of the transferring employees into the purchaser's workforce should be mandated. Given the public nature of the asset being transferred, it is entirely appropriate for Congress to ensure that the benefits of the transfer are shared by the affected employees.

With respect to foreign investment in U.S. carriers the recent action by DOT in the Northwest/KLM case makes it imperative that Congress establish procedures by which such investment will be reviewed. The Act should be amended to prohibit actual foreign control of a U.S. airline. U.S. carriers and their potential foreign investors should be required to file applications for approval of the proposed investment and interested parties should then be afforded an opportunity to review and comment on the applications. if there are material questions of fact as to whether the proposal investment could lead to actual control of the U.S. carrier, a hearing should be required. Congress should also establish a set of factors to be considered by DOT in deciding whether to ap[prove the investment. Among these should be whether U.S. investors can make investments comparable to the proposed investment in the airlines of the investor's home country and whether airlines of the country of the investor are in whole or part state owned. Other factors that Congress should have considered are the identity of the investor, whether the investor's homeland had a fully liberalized aviation bilateral agreement with the U.S., and whether the investment raises national security questions.

Again, thank you for inviting ALPA to appear before the subcommittee today. I would be happy to entertain any questions the subcommittee may have.

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STATEMENT OF KENT T. SCOTT, CHAIRMAN, TWA PILOTS MASTER EXECUTIVE COUNCIL

I am Kent Scott, the Chairman of the TWA Pilot Master Executive Council, which represents over 3,500 pilots employed at Trans World Airlines. The TWA MEC is a branch of the k Line Pilots Association, which altogether represents over 42,000 pilots.

Thank you for giving the TWA pilots the opportunity to address the issues before you today: the sale of international route authority, and foreign ownership of U.S. airlines. These are areas that concern us very much, both as employees of a United States flag carrier with a rich history of international service, and as citizens of a great nation with a global reach and long-range policy goals.

We at TWA feel that discussion of these two vital issues is extremely timely and appropriate in light of the state of the air transport industry in general and our carrier in particular. As you know, the owner of our airline, Mr. Carl Icahn, has started to dismantle TWA through a series of international

route sales, and we feel the impact of his plan to liquidate TWA will have significant national policy implications.

I would like to discuss the sale of international routes first, and then e the issue of foreign ownership of U.S. airlines.

THE SALE OF INTERNATIONAL ROUTES

The sale of one U.S. airline's international route authority to another raises immediate concerns about consolidation in the airline industry and the direct impact of consolidation upon competition, which is the bedrock of our American free trade economic system. As a nation, we have a well-founded cultural bias toward competition which we feel provides many benefits to consumers, such as wider choices, more attractive products, more sensitivity to customer concerns, and more aggressive pricing.

Consolidation in the airline industry is already well into its final phase, and if unchecked, will result in three or four extremely large U.S. carriers serving the entire domestic market, and dominating foreign sectors as well. The process to this point has been crystal clear — the weak get weaker, and the strong get stronger. To a point, this economic Darwinism may be beneficial in weeding out those operators who are too thinly-capitalized to provide safe, reliable air transportation. As the industry collapses around the final four however, it seems obvious that some deeply disturbing economic consequences are inevitable.

In any process such as the auctioning off of international routes, it is evident that those assets which have the most value are the ones which are placed on the block first. The weaker carriers have had a well-documented history of selling prime routes first, and then being unable to survive with what's left, as they are continuously circled by stronger, predatory competitors.

Aviation history is clear, and the lessons are compelling. Panagra sells its Latin American routes to Braniff, then disappears. Braniff sells its Latin American franchise to Eastern, and sinks from sight without that vital revenue. Eastern sells Latin America to American and soon closes down. Pan American sells off the entire Pacific route system to United, and will never survive if it is allowed to sell London routes to American. Icahn has sold one London route to American, and we too will fold if the remainder of the London routes are sold.

During all this time, the "visionaries" who tell us in soothing voices that this is all going according to plan and will benefit the travelling public are ignoring economic reality, and missing an elementary economic conclusion.

The reality is: All of the low-cost airlines are disappearing. The inevitable conclusion will be: The remaining carriers are all going to be high-cost airlines. The industry is imploding around carriers who have the highest employee costs, buy the newest and most ~pensive equipment, and will be capable of putting the American consumer in an inexorable price vice once the final act is carried out within the next year or so.

Price competition, if it exists at all, will center around a much higher fare basis due to the requirement to cover much higher fixed costs when the flood of new aircraft are delivered. Passengers will be at the mercy of the few megacarriers with a handful of hubs around the country. Concentration at those hubs will be such that capacity, frequency, and destinations served will be functions of maximum profit potential, not consumer desires.

Moreover, embedded in the whole issue of international route sales is the treatment of the employees at the airline whose routes are being sold. With a few exceptions, routes have been transferred in the past with little or no transfer of employees. Jobs which were being performed by one airline's workers were moved to another carrier's operation. Although seemingly resulting in a zero-sum effect, in reality there has been a tremendous dislocation and economic penalty involved in this process, due to the fact that the airline business relies so heavily on the seniority system to allocate Jobs.

As one airline downsizes and another expands, there is a double negative economic effect. Employees at one airline are downgraded and displaced, with resulting training costs and unemployment, while at the expanding carrier upgrading employees to new positions carries its own costs for training. If the transfer of the most valuable routes results in the failure of the shrinking carrier, of course the costs are much greater as the unemployment effect is felt across the entire employee base of the failed airline.

Finally, route sales must be viewed in the context of the manner in which the routes came to be acquired originally by the selling carrier. Virtually all international routes were initially obtained by airlines in a competitive route award process at nominal expense. For the U.S. government to allow individuals, or even companies, to make enormous profits from something obtained for nothing is a gross distortion of a rational economic system. In fact, in the specific case of Trans World Airlines, the sale of international routes which TWA obtained years ago from the government for free are being used to directly subsidize the cost of the failed leveraged buyout that Icahn engineered in 1988. There simply will be no economic benefit to the public, TWA as an airline, or the employees of TWA if those route sales are approved. The only beneficiaries will be Carl Icahn himself and the CEO of American Airlines in his quest to dominate the U.S. airline industry.

The subcommittee should consider a sounder, more practical, and more equitable solution to a struggling carrier's troubles than simply allowing it to sell its most valuable assets. The U.S. government should not be in the business of making Junk bondholders whole if LBO's don't work, especially when it is inevitable that entire companies will fail with huge negative economic effects.

Why not confine the economic damage to those constituencies who took the sizeable and foreseeable risks in the first place? If the Junk bondholders are to be bailed out, let there be a marketplace solution, that is, a restructuring of the weakened carrier with a debt-for-equity exchange which restores the enterprise to health while main~g its prospects for recovery.

In summary, the sale of an international route should not be looked at in isolation. There are significant economic consequences which follow the initial event which have national public policy implications. Public policy considerations should dictate that the following sequence occur:

(1) International route sales should be denied in favor of the carrier restructuring its debt instead; (2) cute sales should be allowed only if an acquirer buys the entire company, not Just the premium assets; (3) If route sales are to be considered, a competitive bidding and award process should take place with substantial proceeds going to the government since the routes were obtained in a similar evaluation and award process; (4) If route sales are to be approved at all, they should be subJect to a business plan for the use of proceeds and Job protection for affected workers.

FOREIGN OWNERSHIP OP U.S.

There are four major national policy areas which should concern those who are g the subJect of foreign ownership of U.S. airlines: (1) National security and defense; (2) Cabotage and access to U.S. markets; (3) Macroeconomic effects; and (4) Safety and certification standards.

National security issues are crystal clear in today's environment — the United States must have a ready reserve fleet of civilian airliners available instantly to use in any area of the world for our national interests. As a nation, we cannot afford to compromise our national defense and security requirements for economic or political benefits. No plan should go forward which would permit any foreign government to deny us that airlift capability, or any short-term gains will prove to be illusory in any future hour of need.

Next, the United States should be very concerned about the possibility that foreign ownership could circumvent the measures we have taken to prevent foreign airlines the unrestricted freedom to fly into our markets. It would be the aviation equivalent of the Maginot Line to have built up strong restrictions on cabotage and impressive bilateral treaties, and then allow foreign airlines to bypass that mechanism entirely simply by acquiring control of a U.S. airline. That being said, as a nation committed to the notion of free trade, we need to examine the entire issue of "open markets" to see what we really mean by that phrase.

There Is no question that globalization of the airline industry is going to come about, Just as it has in the insurance, banking, telecommunications, and financial services sectors. It is vitally necessary, however, to learn from the past and make sure we consider carefully the effects of liberalization of our present rules in this area. The United States Is the most lucrative and dependable market for air travel in the world, and we need to make sure that appropriate quid pro quos are extracted in -change for increased access to our markets.

Although the system of bilateral agreements with foreign governments will become outmoded within a few years due to the actions of the European Economic Community and other large regional trading blocs which will almost certainly develop in the vast areas of the Pacific in the 1990s, the principle of value for value must be respected in some form. Therefore, the whole issue of foreign ownership must be looked at in the context of replacing bilateral type protections of our trading interests with foreign-ownership evaluations conducted under rigid, national policy standards applied at the highest levels.

The macroeconomic impact upon the U.S. economy is a critical factor to be considered in any discussion of foreign ownership of our airline industry. This should not be different than the same consideration of any other industry.

Each nation in the industrialized world had to give serious thought to the impact of allowing foreign investment into its economy. Although capital investment is welcome in many cases to stimulate a business, an industry or an entire economy, it is vital to follow the flow of money through the economy to determine its ultimate effects.

Much of the initial benefit of capital investment into a business from foreign sources would be lost if the business employed only foreign worker who would pay little or no local taxes and would repatriate a significant portion of their earnings. We would view it as against our national policy interests to allow a foreign company to set up a factory in the United States, hire only foreign workers, and let them send their paychecks home to deposit in their own offshore banking system.

We would view this process with even more skepticism if this new foreign- owned factory were replacing a U.S. industrial plant in which American workers were paying taxes, spending their money here, and placing the ex:cess into the U.S. banking system, available for reinvestment purposes with the resultant multiplier effect upon the economy.

Our resistance would not be confined to an industrial plant producing durable goods such as automobiles or computers, but would extend to the service sector as well. We would have the same reluctance to view favorably an investor in a McDonald's franchise who would employ only foreign workers who would not pay taxes or spend or save money in the U.S.

Our reluctance to approve of these types of foreign investment is more than industrial chauvinism; it is founded in sound macroeconomic considerations. Every industrialized nation understands that the return on investment from the price of finished goods is important, but that a far more significant

economic effect is achieved by the taxation, spending tendencies, and savings rates of the skilled labor force employed by the nation's industrial and service sectors.

Although we tend to think of aircraft as highly mobile and transient, it is essential that national policy considerations are taken into account when contemplating foreign investment in our airline industry. A commercial aircraft can be viewed as a moving factory, using skilled labor to combine consumer demand (a passenger's desire to get to another point on the globe) and raw material (fuel, flight crew) to produce a finished product (safe delivery to that point).

If we understand that basic principle, we should find it no more acceptable to allow a foreign investor to operate a foreign-owned airline within the United States with foreign workers who pay no taxes, spend no money, and place no deposits in our banking system, than to build a factory here with the same unacceptable socioeconomic parameters.

There has been a pronounced tendency to view the argument about foreign investment in the airline industry as solely a labor protective issue, when it is glaringly obvious that important national economic considerations rise above any labor component of the debate.

Thus, the macroeconomic effects of foreign investment require that policymakers place strict limits on the exportation of Jobs and the associated repatriation of wages and benefits accruing to the skilled labor force required to produce the product.

The final area of concern for those responsible for determining national policy should be the consideration of safety and certification standards for workers and equipment.

The airline business is extremely safety-conscious. We operate on a "zero-defects backed up by redundancy" philosophy in every aspect of our work. Airlift placed into civil service are subJect to an intensive certification process, and then watched carefully the rest of their service lives over a quarter-century or more.

Flight crews are required to perform their tasks under the most intense scrutiny of any professional workforce in America, with stringent physical and performance standards which have no parallel in our society. ~gular, unannounced testing of our Job performance can take place at a moment's notice. The public trust is at stake, and the management and labor forces alike understand the importance of the safety and reliability of the U.S. airline system. The American public has access to the safest and most dependable system of air transport in the entire world, and we must do everything we can to preserve that well-deserved reputation, especially in the face of persistent pressure to cut costs in our industry.

Our best posture as a nation concerned about safety and reliability in the aviation industry is to assure that those standards for safety and certification be maintained at the absolute highest levels. We can have the highest degree of confidence in our ability to maintain those standards by continuing to certify to the American public that we have direct control over the equipment and personnel who are responsible for the carriage of passengers within our borders. This means that we employ U.S. citizens with U.S. licenses to fly and maintain aircraft which have met the highest standards of our government for certification.

We should not, as a nation, be tempted to "trade away' our skilled labor force and our rigid standards for flight equipment in some vague and misguided attempt to curry favor with some foreign government in unrelated commercial or diplomatic areas. The safety of our passengers should not be for sale, and the three-quarters of a century of direct operating experience that we have gained should not be taken for granted.

In conclusion, the issue of foreign investment in the U.S. airline industry should be ed carefully for national policy considerations. Benefits could be provided to the national interests by providing capital for a highly capital-intensive industry. The stability and long-term future of an airline could be enhanced by significant foreign investment, which would be positive.

The macroeconomic and safety factors, however, require that U.S. policymakers preserve control for U.S. airlines in our own hands, and similarly require that the extraordinarily high standards for equipment utilized to carry passengers within the country be maintained. Finally, it is obvious that the economic value of preserving the Jobs of skilled American workers in this industry is vital to our national economic interests.

Again, thank you for inviting the TWA pilots to appear before the subcommittee today. I would be pleased to answer any questions the subcommittee may have.

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AIR LINE PILOTS ASSOCIATION,
*Washington, DC. March 12, 1991*

HON. WENDELL H. FORD,

*Chairman Aviation Subcommittee, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, DC.*

Dear Senator Ford:

This is in response to your February 27, 1991, letter asking for responses to written questions submitted by Senator Hollings following the Aviation Subcommittee's February 19 hearings on foreign ownership and route sales. I appreciate this opportunity to elaborate on my testimony during those hearings.

Senator Hollings' first question asked for suggestions on what sort of standards or procedures Congress should consider requiring in route authority transfer cases. Given the large number of route transfer cases recently concluded and pending before the Department of Transportation and the impact of those sales on the carriers concerned and their employees, this is a timely and important question.

First, as I stated in my testimony, ALPA believes that Congress should amend section 401(h) of the Federal Aviation Act to prohibit route sales that undermine the financial viability of an airline. The need for such an amendment is made painfully clear by the current effort of TWA to sell its U.S.-London authority to American Airlines. These are certainly TWA's most valuable routes and are at the heart of an international route system that the airline has recognized, in its own submissions to the DOT, as the key to its future. ALPA believes that the sale of the routes will lead to an acceleration of the airline's financial losses and the speedy demise of the carrier.

Second, ALPA believes that because route rights belong, at bottom, not to individual carriers but to the United States, that any proceeds of their sale should be used to advance public, not private interests. Accordingly, Congress should require that any carrier that wishes to sell the rights that have been entrusted to it must first present a realistic plan of how it intends to use the proceeds of the sale to enhance its competitive viability.

Third, routes mean jobs and the transfer of international routes frequently means lost jobs. Thus, the Act should be amended to require a carrier acquiring route authority to offer jobs to the number of the transferring airline's pilots necessary to operate the routes. The Act should provide for the fair and equitable integration of transferring pilots into the workforce of the acquiring carrier.

Senator Hollings' second question asks for comments in what sort of process and standards should be employed in reviewing foreign investments in U.S. carriers. This, too, is a timely and important question given the large ownership stakes that several foreign carriers have recently taken in our airlines. As I testified during the February 19 hearings, ALPA recognizes that foreign investment in U.S. airlines is not in and of itself undesirable. However, in my testimony I also explained several of the reasons why we question whether foreign investment is a miracle-cure for our industry and why we are concerned about the possibility that foreign carriers may gain control of U.S. carriers.

Because we are concerned that foreign control of U.S. airlines may have a negative effect on our national interests, ALPA would propose amending the Act to explicitly prohibit actual foreign control and to require that significant foreign investment be subject to prior review by DOT in a public proceeding. More specifically, if an investment stake of more than ten percent of a carrier's equity is contemplated the investor and the airline should have to file an application with the DOT requesting approval of the investment. Interested public parties would be afforded an opportunity to participate in the proceeding and to comment on the application. If there are material questions of fact as to whether the proposed investment could lead to actual control of the U.S. carrier, a hearing should be required.

In addition, Congress should establish a set of factors to be considered by DOT in deciding whether to approve the investment. Among these should be whether U.S. investors can make investments comparable to the proposed investment in the airlines of the investor's home country and whether airlines of the country of that investor are in whole or part state owned. Other factors that Congress should have considered by DOT are the identity of the investor, whether the investor's homeland has a fully liberalized aviation bilateral agreement with the U.S., and whether the investment raises national security questions.

Again, I appreciate the opportunity to provide these supplemental comments and hope that we will be able to work together in crafting and passing legislation on these important issues.

Sincerely,

J. RANDOLPH BABBITT, *President.*

Senator BRYAN. [Presiding] Thank you very much, Captain Babbitt. We will begin this round of questioning with Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

Captain Babbitt, I have only one question that I think might be helpful for the record. What happens when these airlines go under? What happens to the pilots, the air crew, the employees? Do they all just go next door to an existing airline and get a job at the same level? Do they get to stay in their home, maintain it where it is? Is everything just a nice, easy transition for these people, particularly in the area of pilots and air crew that have built up seniority in the airlines before they went under?

Mr. BABBITT. No, sir. Unfortunately, they do not enjoy the opportunity to do as you suggested and just transfer in most cases because two events have not occurred.

First, the labor protective provisions that the DOT is empowered to enforce have never been enforced in any route proceeding since deregulation.

Secondly, the employee protective provisions that were part of the deregulation act were to last 10 years. They were not written for 9-1/2 years, and they have never been applied. So no one other than by the generosity of an acquiring carrier, which to my knowledge has only happened once, or by the enforcement of internal rules we have within the Air Line Pilots Association have we gathered any employment whatsoever, and it, unfortunately, is so meager it is not worth mentioning.

In the actual case, realistically, it usually places those people out of work and, at the best, they can go to work with a complete loss of seniority at the bottom of a seniority list of a carrier who happens to be expanding if they are fortunate, if they are young enough, and if they can compete in the hiring line. I can assure you there is not a big demand for 55-year-old airline pilots.

Senator BRYAN. So generally, what has happened is that these people has basically lost their means of employment?

Mr. BABBITT. Yes, sir.

Senator MCCAIN. That goes for other crew as well and maintenance people?

Mr. BABBITT. The general rule, yes, sir. I would say that in most cases the cabin crews in addition to the cockpit crews and oftentimes the support crews on the ground, the maintenance facility operations, all the support, fuel, catering, et cetera, depending on the ownership, depending on how the airline is structured, all suffer a tremendous loss.

Senator MCCAIN. Thank you very much, Mr. Chairman.

Senator BRYAN. Thank you very much, Senator McCain.

Senator Danforth.

Senator DANFORTH. Captain, asking you about a hypothetical airline that begins with a "T".

Senator McCain said earlier that the problem with selling off the international routes is that there may be a cash infusion for a few months but the airline really is not viable. It is left with its weakest parts, and it is more sure to go under. I agree with that and have been doing my best to fight what appears to be kind of a rear guard action to delay the sale of international routes by a hypothetical airline.

Now I know what you are against. I am not quite sure what you are for. I think we have to figure out how we solve a very practical problem.

I must say that when I first heard about opening up the ownership of airlines, I thought, oh, come on. It just hurts my pride, among other things; but I do not know from where the money is going to come. Every time I fly TWA, which is extremely often, I am asked by TWA employees what is going to happen, what do I think is going to happen. I always say to them figure out who the buyer is. We have to get somebody to buy this airline.

If there is no one who wants to operate TWA domestically, I wonder whether we really want to foreclose or severely limit the availability of the airline for somebody who does want to operate a verifiable airline. Suppose there is some other airline that has routes across the ocean and they want to buy it. Why should we say no? Just let them go. To me, it is something that at least should be explored. You know, a month or two ago I would not have said it, but when you are faced with a very bad situation sometimes you take a second look at some things that you had not considered before.

So that would be my question to you. Is it just totally beyond reason as far as you are concerned, beyond consideration that we should be at least raising the questions about foreign ownership?

Mr. BABBITT. No, sir. Let me break your question down, if I could, into several parts. One, regarding the foreign ownership in and of itself, we fully recognize

that there are situations where the investment of capital might be wholesome. But I think if you will look and allow me to split this into a short term and a long term, if we need some cash and we need a short-term solution, we propose some alternatives, some band-aids, if you would.

But I think while applying those band-aids we had best step back and look at what we are trying to do for the overall national transportation policy and specifically what does this country want for a domestic national transportation system.

The original purpose of deregulation was to create a heightened, increased level of domestic competition. So when we somewhat, in my opinion, make an indictment of the current system when we say, but no one wants to buy this carrier, we have people with foreign money that would like to buy it, I would submit to you that if it is a bad investment for a man who lives in Kansas City or New York City, it is a bad investment for a man who lives in Amsterdam. There can be only one reason that he would like to add money to what is obviously a poor investment, and that is control.

We are fearful that control and the tentacles of the control problem branch out very broadly. It undermines the bilateral negotiation process. We are also concerned, for example, where the carrier making the investments looks to purchase or control, if you would, or have substantial investments in another carrier that they directly compete with. How competitive can we actually expect that they will be in the future? Will they be as competitive as perhaps Continental was to Eastern Airlines when Texas Air Corp owned both airlines? I do not think so.

So that is at the root of our control concern. Why does no one want, why do U.S. dollars not want to go to these carriers? I think we have perhaps come to the conclusion that we have produced so much intense competition that they are not good investments as currently structured.

The second part of your question let me address in terms of is it okay for someone like your hypothetical carrier to sell off a portion of itself? We have acknowledged here, it has been testified to and submitted here that clearly we have already sold off all the nonoperating assets.

The carriers have gone through and sold the rental car agencies, the hotel chains; all of those are gone. We are now down to selling operating assets. This is analogous to burning your furniture to stay warm. It will work for a winter or two, but then it will get pretty chilly about the third time around.

I am fearful that by doing what we suggest today, concentrating into several carriers, and then when the cry comes that we do need some new competition, we do need another breath of competition in here, we will open the doors to foreign competition; we will just go through the same cycle once again; and we will be back in these same hearing rooms 8 years from today saying now there are only three carriers. Unfortunately, one of them will be U.S. and two of them will be global, and we will be out of the picture altogether.

Senator DANFORTH. I agree with you on point two, and I used to agree with you on point one. I am just saying that when you are falling off of a building you sort of hope somebody is going to catch you.

I am reluctant to say, oh, no, I do not want it to be you; I want it to be somebody else who exists.

Mr. BABBITT. Well, with regard to the foreign investment itself, we are looking more for the review and the assurance, the follow-up review, the threshold of continuing review as the landscape is altered. The original investment might well have been within preset parameters, but future stock sales,

repurchase, and so forth could change that. It should be subject to an ongoing review.

Let me focus for one second back on the TWA piece when we talked about review or, excuse me, the fictitious airline. The process there that we look to is the process of having the ability to evaluate completely what the sale will do to the ongoing airline. And I would add there that we use the analogy inside, if you took a major component out of your transmission and sold it, would your car still run? That is what we look to.

What are you going to do with the proceeds? Is it viable without it? Kent Scott, who is with Trans World, may well have a comment to add.

Mr. SCOTT. Well, I do. Thank you, Randy. And thank you, Senator, for your interest. Your interests and mine, I think, are very similar about this unnamed airline.

Let me just go through what I think is the critical issue here and that is, what will the airline, the unnamed one and the unnamed investor named Carl Icahn, to do with the proceeds of the transaction?

Let me tell you what he relayed to me personally as to what was his game plan. He was going to buy Pan Am. Now this was going to involve an impossible contradiction of buying the common stock for $375 million and then issuing debtor-in- possession financing, which is incompatible with buying the common stock. And now the common stock is selling for $.50 a share.

He was going to redeploy the assets and add extra flights to Florida. He was going to add an extra bank of flights to St. Louis to take care of your constituency. He was going to re-enter the Trans Continental market and reopen the Los Angeles base. And he was going to increase service out of Midway Airport.

Now the interesting thing about it is that within the previous 60 days of him telling me this, his senior management had convinced him that none of those moves made sense. And in fact he had pulled out of every single one of those particular markets. So I find it interesting that that was how he was going to use the physical assets redeployed from the London situation.

He also made a statement that was widely reported in the press that there would be no job losses as a result of the potential sale of the London routes to American Airlines. Now I have asked him in two certified letters to document that and spell out how he is going to preserve those jobs. I have not received any reply about that.

In fact, I am intrigued by the Secretary of Transportation's assurances that employees will flow smoothly over to another carrier. I would like to see how that is going to work.

I think it also is important to focus on the fact that at TWA specifically the problems of the airline are not labor- cost related. The labor costs at TWA are the lowest in the industry of any carrier who is not currently operating in bankruptcy. So labor costs themselves are not an issue.

However, the issue is the leveraged buy-out of 1988 and the extraordinarily high debt load that that created. There is no airline in the United States that can earn enough money in any quarter, whether it is a normal quarter or an extraordinary quarter, to cover the leveraged buy-out debt that was generated in 1988.

I would submit that although you people here on the subcommittee have been told that there are only two possible solutions, that is asset sales or foreign investment, I believe very strongly that there is a third solution. That is to let the capital markets work the problem out themselves via a restructuring of the debt. That would involve converting debt to equity.

Any publicly-held company's board of directors would probably be quite enthusiastic about this. But in this particular case, of course, that would involve

Carl Icahn losing control of the carrier. And I think that that would be unacceptable in his mind.

But if you look at taking London out of the TWA route system, you are condemning the carrier to death. You are signing its death warrant because it cannot possibly reorganize around a core structure which cannot generate operating income. And that is what the situation would be.

I would respectfully submit that the need for cash is used for one thing and that is to pay your bills. If you can reduce your bills, that is a third way to handle the problem.

Senator DANFORTH. Thank you. Thank you, Mr. Chairman.

Senator FORD (presiding). Captain, the Secretary of Transportation seems to think that labor costs are a problem in the airline industry. What is your response to that?

Mr. BABBITT. Well, first my answer is always piqued that he even comments, seeing that he is the Secretary of Transportation. I might expect that from the Secretary of Labor. But unfortunately the facts simply do not support his position.

No matter what gauge you use to judge this against, in real dollar terms the airline pilots of today and labor in general of the airline industry are paid less. I would be very curious to find the airline that he has. It is a fictitious airline, apparently, that has, in fact, enjoyed an increase. There are not any.

As a percentage of revenue the amount that is paid to labor has decreased since the point of deregulation. And no matter what measure you put on it, if you use the pilots for example, the pilots are typically on average around 9 percent of the revenue of the carrier. Prior to deregulation that number was closer to 13 percent.

As you can see, that has declined over a period of time. Aircraft are larger. They are more efficient. We are more productive. All of these lead to the decrease in our unit cost and actual real dollar cost.

Senator FORD. I think you have suggested legislation to prohibit route sales that would, in your opinion, or in the opinion of others, undermine the financial viability of a carrier. But how would you answer those who say that selling a particular route is essential to the survival of the carrier?

Mr. BABBITT. Senator, I would suggest that in those cases, there may be appropriate cases, there may well be where the cash, where the particular route is not helping the carrier, and it has viability or a value and could well produce something beneficial for the carrier to be sold. But we would want an objective review prior to the sale, what impact the sale, the removal of that part would have from the selling carrier and what does the selling carrier propose to do.

Most of these, if you will recall, are in distress situations. The carrier is in trouble. That is why they are selling viable parts of their airline. So what is it that they propose to do and what is their plan to deal with the proceeds in the long-term? Under those terms, we think it is quite normal and quite acceptable for them to entertain sales of portions of their operation.

Senator FORD. I have no further questions.

Senator McCain, do you have any?

Senator MCCAIN. No, Mr. Chairman.

Senator FORD. Thank you, Captain. We look forward to visiting with you again from time to time. Thank you for your testimony today.

Mr. BABBITT. All right, sir. Thank you for the opportunity. We appreciate it.

Senator FORD. Our next witnesses will be on a panel consisting of Mr. J. Thomas Talbot, Chairman and CEO of Hawaiian Airlines, Mr. James W. Callison, Senior Vice President, Corporate and External Affairs of Delta Airlines, Mr. Alfred A. Checchi, Chairman of Northwest Airlines, and Mr. Edward Beauvaise, CEO, America West Airlines.

Mr. Callison, I understand that you have already missed your airplane?

Mr. CALLISON. Yes, sir, Mr. Chairman, I was going to see the Governor of Kentucky, but I think I am going to miss that appointment now. But we will have some other opportunity.

Senator FORD. We have already passed some legislation to take care of you. It is just a matter of letting the ink dry.

Mr. CALLISON. I want to say thanks to him and celebrate with him, but we will do that another time.

Senator FORD. Mr. Callison, if you would wish to start off, we would be more than pleased to hear from you.

## STATEMENT OF JAMES W. CALLISON, SENIOR VICE PRESIDENT, CORPORATE AND EXTERNAL AFFAIRS, DELTA AIR LINES

Mr. CALLISON. Thank you, Mr. Chairman and members of the subcommittee.

Delta appreciates greatly the opportunity to present our views concerning the two international policy issues that are before you, one, international route transfers, and second, the question that you have just been talking about, foreign investments in U.S. airlines.

Let me start by noting that Delta has an extensive international expansion program, to aggressively compete in the global market place. We are doing that based largely on internal growth out of our hubs. Consistent with that objective, we have placed orders and options for 65 aircraft that will be dedicated entirely to international operations.

Now ideally the implementation of Delta's and other carriers' international growth plans could best be accomplished through a relaxation of the numerous restrictions, limits and controls that still exist in many of our present aviation bilateral agreements.

However, while there is a trend toward liberalization in that area, restrictive bilateral agreements will continue to govern many international markets. As a consequence, the industry will have to continue to rely upon the Department of Transportation to select carriers and to process route transfer proposals in limited entry markets. And in such markets special care must be taken by DOT to create and to preserve competition among U.S. carriers.

Now in this context let me discuss first the issue of international route transfers. Delta does not object to the buying and selling of international routes. We have purchased some international routes ourselves where they would strengthen our internal plans for international growth and expansion.

We believe that a secondary market of route transfers can, in some cases, preserve and even enhance the public benefits envisioned by the original route awards.

Nevertheless, DOT must carefully scrutinize every proposed transfer to insure that competition among U.S. carriers will be preserved and enhanced. Just last year Congress and this subcommittee emphasized the important competitive issues that the Department of Transportation must consider in reviewing a proposed transfer of international route authority.

Your standard requirements, including a special report to Congress regarding route transfers, underscore the need for DOT to approve only those proposed transfers that will preserve or enhance competition among U.S. airlines, both in international markets and, within the United States, in markets that feed international gateways.

Historically the Department has consistently adhered to a policy of creating inter-gateway competition among U.S. carriers in making initial carrier selections in limited entry international markets. Similarly, the underlying internation-

al routes have been negotiated in almost every instance and created with the objective of maximizing multiple U.S. carrier competition between this and foreign countries.

Those same policies, in our view, must be followed in current and future route transfer cases as well, even in times like this when financial stresses create pressures for expedition.

In short, DOT has, we think, the responsibility under section 401(h), to prevent transfers which might preclude effective and meaningful competition between U.S. carriers.

It was in light of those DOT responsibilities and because of Delta's desire to remain a strong U.S.-U.K. competitor that we requested the Department to conduct an oral evidentiary hearing to fully consider the United-Pan American and the American-TWA route transfer proposals and their implications for future U.S. carrier competition to and from the United Kingdom.

On their face these two transfers, combined, threaten a virtual U.S. flag duopolicy in the U.S.-U.K. market that would seriously impair U.S. carrier competition to and from the United Kingdom.

American's U.S. gateway authority to London would leap from three to 10 gateways—nearly half of all the U.S. gateways authorized under the U.S./U.K. bilateral. American would be able to control traffic over these many hub gateways and thereby adversely impact the ability of all other U.S. carriers to compete for traffic between the interior of the United States and the United Kingdom. The transaction involves multiple routes to a single, restricted-entry country, and would therefore confer significant market concentration upon the purchaser. If these routes were available in a carrier selection case, a new route case, DOT would never consider awarding all seven of them to a single airline.

We strongly believe that the Department should examine these potential problems in detail and should weigh the desirability of various preventive conditions that would lessen the threats to competition such as required spin-offs of some of the routes involved—a determination that can best be made through the hearing process.

Since these hearings were scheduled the United-Pan American transaction has been approved without such a full examination in a hearing.

But we sincerely hope that the Department will take a different approach to the proposed American-TWA transaction, with all due respect to Senator Bentsen, will set it down for a full hearing, and will take final action that preserves vigorous competition among U.S. airlines to and from the United Kingdom.

Let me quickly turn, in conclusion, to the question of foreign investment in U.S. airlines. In our view, Secretary Skinner has appropriately reexamined the Department's policies on foreign investment in U.S. airlines. Given the critical financial condition of our industry, certain airlines, not Delta, but certain airlines may need new sources of capital, and U.S. airlines must be able to respond to new market opportunities in the rapidly changing global market place.

We agree with the Secretary that the existing limits on foreign ownership of voting equity should be maintained. But we are concerned with allowing the overall equity ownership by foreign interests to go as high as 49 percent at this time—and with no restrictions on foreign debt.

It seems clear to us that foreign airline investment, as you indicated, Mr. Chairman yourself, it seems clear to us that foreign airline investment in U.S. airlines is motivated in many cases by reasons other than financial gain.

Delta does not believe that these are passive investments. Rather, foreign airlines are interested in acquiring substantial equity positions in U.S. airlines in

order to strengthen their presence in the U.S. marketplace and provide needed fee traffic over their U.S. gateways to foreign destinations.

It appears to us that carriers like KLM and SAS have acquired large equity investments in U.S. airlines in order to position themselves for that time in the future when U.S. laws restricting foreign ownership are further relaxed, when cabotage is permitted, and when they can then fully enter into interior U.S. markets.

Our primary concern, let us not be misunderstood, our primary concern is not the creation of real or potential competition for Delta or any other carrier in the U.S. market place, but rather the concern is the dampening effects that substantial ownership stakes would have on U.S. Government initiatives to liberalize those currently restrictive bilateral agreements that I referred to earlier.

For example, if British Airways or Japan Airlines were allowed to make substantial investments in U.S. airlines, there would be little, if any, incentives for those countries to liberalize their highly restrictive bilateral agreements to permit Delta and other U.S. carriers to compete on a fair and equitable basis with their airlines.

Accordingly, we would be more comfortable, I know there are many sides to this issue, but we would be more comfortable with a policy that, as a first step, would limit foreign ownership of overall equity levels of no more than 35 percent or 40 percent, both non-voting and voting combined, not as high as 49 percent and, of course, limiting voting stock, voting equity, to 25 percent or less. And we would say that should be allowed even then only if the investment comes from countries, that do not restrict U.S. carrier entry.

We would rather see a cautious step first, instead of going quite as far as the Department has thus far indicated.

Thank you, Mr. Chairman. My time is, I am sure, up. I will be very pleased to answer questions later if you want.

[The statement and questions answers follow:]

STATEMENT OF JAMES W. CALLISON

Mr. Chairman and Members of the Subcommittee, I am James W. Callison, Senior Vice President-Corporate and External Affairs for Delta Air Lines, Inc. Delta greatly appreciates the opportunity to appear before the Subcommittee to provide testimony on the two international policy questions — international route transfers and foreign investment in U.S. airlines — that are the subject of today's hearing. You are to be commended for holding these hearings to review these important policy issues, which will have a profound impact on the competitive structure of the U.S. airline industry as it responds to the changing global marketplace.

Since receiving our initial transatlantic service award some thirteen years ago, Delta has aggressively pursued an international expansion program. Our company now serves twenty-five (25) international cities in eleven (11) different countries. Our primary objective has been and is to build upon our domestic strengths in the United States by expanding our international services from Delta hub cities to both European and Pacific markets. We recognize that Delta and the rest of the U.S. airline industry must continue to aggressively pursue an international network if we are to compete in the future in the global arena. Unlike some of our competitors, Delta's strategy for expansion primarily relies upon internal growth and not acquisitions to expand our international service. Consistent with that objective, Delta has placed orders and options for 65 aircraft that will be dedicated to international operations. Delta fully recognizes that if we are to remain a strong and effective competitor, we must have an extensive well structured international route system that will enable us not only to compete for traffic between the U.S. and foreign destinations, (and, thereby, better promote competition within the United States), but ultimately for traffic within every major region of the world.

The movement toward freer, open trade in international markets will depend ultimately upon the relaxation of current restrictions on market access. At present, the U.S. air transport industry is severely constrained by existing aviation bilateral agreements. Unfortunately, the vast majority of such agreements are highly restrictive and impose undue limits and controls on competition. While the trend toward liberalization has been steady, restrictive bilaterals remain a significant impediment to greater competition. Delta will continue to support and advocate a more open international regime that relies upon the marketplace to determine the quality and quantity of service provided between and among the various countries of the world.

In circumstances where bilateral agreements remain restrictive, and where the Department is required to select carriers to serve limited entry markets, it is even more imperative that the Department properly apply the statutory public interest tests in a way that maximizes competition.

Let me now turn to the issue of international route transfers.

## INTERNATIONAL ROUTE TRANSFERS

Delta agrees with recent statements by DOT officials that the government's role in allocating international route awards should be minimized and that, to the greatest extent possible, the marketplace should determine international route authority. But even with a liberalized regime, the U.S. airline industry will still have to rely on the Department of Transportation to make decisions concerning international route awards and international certificate transfers that will maximize competition and the public benefits provided by these international services. As the industry restructures and positions itself for a more open and global competitive environment, it will be especially important that the U.S. Government maintain consistent and clear policies to sustain and enhance airline competition. This is especially so now during this period of rapid restructuring of the industry.

Delta does not object to the buying and selling of international routes. We believe that the "secondary market" which has existed over the years has produced public benefits, and that a market mechanism for transfer of these important government franchises can assure a continuation or even expansion of the public benefits envisioned by the original route grant. Delta has recently acquired international routes, and we will continue to be active in purchasing routes that will strengthen our overall international route system and complement our own internal plans for growth and expansion.

Just last year, Congress, and this Subcommittee in particular, recognized the important competitive issues associated with the transfer of international route authority under Section 401(h) of the Federal Aviation Act. The new requirement mandated under Section 401(h) reiterated and reinforced Congress' directive to DOT to thoroughly review and analyze all international route sales. The standards and tests mandated by Congress last year in the Aviation Safety and Capacity Act are useful and important guidelines for judging proposed transfers. Transfers of single routes do not generally raise major competitive or structural concerns and can be normally dealt with by expedited procedures. But, transactions that involve multiple foreign routes — particularly multiple routes to a single restricted entry country — which confer significant market concentration upon the purchaser require a thorough, careful and searching analysis of the consequences of such transfers on competition in the international marketplace and the viability of the carriers.

Historically, the Department of Transportation has done an adequate job in discharging its responsibilities under Section 401(h). However, the dire financial condition of many airlines now selling international route certificates has intensified the pressure on DOT to act quickly to approve proposed route sales. Unfortunately, DOT failed to provide a report to Congress consistent with the new law analyzing the effects of several recent route transfers. We hope that the need for an expedited decision will not take precedence over the requirement for a thorough examination of the public interest issues associated with the route transfer.

Both Secretary Skinner and Secretary Shane have on several occasions in recent weeks attempted to clarify, and to some extent redefine, the Department's policies relative to the buying and selling of international routes. On each occasion, these officials have reassured the industry, Congress and the general public that the Department will not interfere with the workings of the marketplace provided the transactions are not "anti-competitive", and that quality of service will be preserved consistent with the public interest. We certainly agree with that formulation. However, our concern is that the principles that have guided the government's policies in negotiating more liberal bilateral agreements and in selecting U.S. carriers to serve routes available in limited entry markets will not properly be applied in current decisions to transfer international route certificates under conditions of financial stress and seeming need for expedition. In decision after decision on route awards over the past ten years, the Department has consistently adhered to a policy designed to enhance intergateway and intragateway competition.

Similarly, we believe that longstanding and recent statements of DOT policy prohibiting the sale of international routes that have never been operated by the carrier awarded the service should be maintained. To do otherwise would negate DOT's carrier selection process in new route cases and severely undermine the integrity of the application process. If newly granted and unused authority may be sold, the Department of Transportation might as well replace the present carrier selection process with a lottery or auction to allocate new route opportunities. It is because of Delta's desire to be a strong, long term competitor in the U.S. -U.K. market that we asked the Department of Transportation to conduct an oral evidentiary hearing and take the necessary time to fully consider the United-Pan Am and TWA-American U.S. -London route transfer applications and condition them (e.g. by requiring spin-offs of specific routes). If both of these transactions are approved as proposed (and one has been since these hearings were scheduled), we believe the Department will have created the potential for a virtual U.S. flag duopoly across the Atlantic that will seriously impair the ability of other U.S. carriers to compete effectively on routes to the United Kingdom, and which will undermine the Department's pro-competitive principles properly applied historically for new route cases. Unfortunately, the Department rejected Delta's motion seeking an oral evidentiary hearing on

the Pan Am-United proposals. Hopefully, DOT will make a different decision relative to the American-TWA transaction.

As reflected in the attached chart, the transfer of U.S.-London route authority to the two largest U.S. carriers will enable United and American to serve nearly 80% of all U.S. traffic to London. These two carriers will also have exclusive rights to serve the primary London airport, Heathrow. More importantly, their ability to control traffic over their hubs will adversely impact Delta and other U.S. carriers competing for passengers between every major region of the United States and the U.K.

It is our sincere hope that, as we have argued in our pleadings, the Department will conduct a thorough examination of the competitive implications associated with the American-TWA route transfer. With the possible exception of the transfer of Pan American's Pacific routes to United, this transfer application (even aside from the United-Pan American transfer) represents the largest and most significant transactional restructuring of the international marketplace that has ever been presented to the Department. If approved as proposed, American will hold authority to provide service to London from ten U.S. gateways — nearly one-half of all the U.S. gateways authorized under the U.S.-U.K. bilateral agreement. We believe that the size and scope of this route transfer application warrant a public proceeding to determine whether the transfer of so much U.K. authority to one carrier would be in the long term interests of the United States. A formal evidentiary proceeding in this instance would be consistent with the decision that the Department made when presented with a similar situation involving the acquisition of Pan Am's Pacific routes by United. If a comparable number of new route awards were available in a carrier selection case, the Department would never consider granting one carrier such a large number of routes in a highly restrictive market. It is for these reasons that Delta strongly believes that the Department must condition approval of this route transfer application on a spin-off of some of the routes in question in order to give Delta and other carriers the opportunity to effectively compete in the U.S.-U.K. and U.S.-European markets.

The anti-competitive nature of the American and United transactions are compounded by the British pronouncements in recent negotiations with the U.S. that enormous concessions will have to be paid to the British in order for American and United to replace TWA and Pan Am as successors at London Heathrow Airport. The British have also made it quite clear that they will not consider any U.S. Government request to increase the number of gateways available at this time for U.S. carriers to serve London. As a result, we are currently engaged in negotiations to determine the price that all other U.S. carriers serving the United Kingdom will pay in order for American and United to compete with British Airways at Heathrow.

From a public policy perspective, we are concerned that the standards and the principles applied by the U.S. Government in negotiating and allocating routes in limited entry markets are being cast aside in the currently expedited and even truncated proceedings on the United-Pan Am and American TWA proposed transfers, and that these hasty, potentially anti-competitive actions will become precedents for the review of future route transfer applications under Section 401(h). We believe that Congress and the Department should make it very clear that route transfer applications should not be approved when these transactions significantly diminish the ability of U.S. carriers to compete in limited entry markets. While we agree that it is important for the Department to approve transactions that will strengthen the ability of the U.S. airline industry to more effectively compete with foreign airlines, this objective must not take precedence over the need to preserve vigorous competition within the United States among U.S. airlines. Let me now turn to the other major issue the Committee has asked me to address in my testimony.

## FOREIGN INVESTMENT IN U.S. AIRLINES

The question of modifying existing U.S. law and governmental policies concerning foreign ownership and investment in U.S. airlines is directly attributable to the need for new sources of capital for some U.S. carriers. As the financial condition of our industry deteriorated in 1990, that need became more apparent. To that extent, Secretary Skinner has, in our view, appropriately re-examined the Department's policies on foreign investment in U.S. airlines, although Delta does not entirely agree with the Departments decision in the Northwest/KLM situation.

As the trend toward globalization occurs, it is also timely to re- examine our ownership and investment policies to determine whether changes should be made in order to give U.S. airlines greater flexibility in responding to new market opportunities. Delta has entered into equity partnerships with Singapore Airlines and Swissair. We acquired a 5% ownership stake in both of these foreign carriers, and they have taken a reciprocal ownership interest in Delta. Neither of these investments involve representation by foreign nationals on Delta's Board of Directors. We believe that this alliance will greatly enhance our ability to expand the three carriers' international presence in certain regions of the world where one or the other does not presently enjoy a significant market presence. In addition, these equity relationships have enhanced our ability to enter into important marketing, training and technical services arrangements with the other two carriers that provide important synergies for growth and development.

Secretary Skinner's recent decision to permit an increase in foreign equity participation in U.S. airlines up to 50% does, however, raise some important policy questions regarding actual or potential control of U.S. airlines by foreign entities. We agree that preservation of the existing statutory limits on foreign ownership of voting equity as contained in Section 101(16) of the Federal Aviation Act

should be preserved at this time. The substantial civilian airlift participation in the Desert Shield and Desert Storm operations suggest that there continues to be a strong need for maintaining citizenship requirements in the event of a national emergency. It is important to note that commercial airlines provided nearly 63% of the passenger capacity and 23% of the cargo airlift needed for our military operations in the Persian Gulf theatre.

The primary issue in the recently announced policy of the Department of Transportation on foreign investment in U.S. carriers is whether such a high level even of non-voting (or total) equity involves control of U.S. airlines by foreign entities. We certainly would be more comfortable with a policy that limited participation to levels no greater than 35%- 40% of total equity, both non-voting and voting combined, with the latter confined to 25% or less. I would suggest to the Subcommittee that the unsatisfactory performance of the U.S. airline industry in achieving adequate returns on investment does not make U.S. carriers an especially attractive financial investment, and that foreign airline interest in U.S. airlines may, therefore, be motivated by objectives other than financial gain. Delta does not believe that these are passive investments. We believe that foreign airlines are interested in acquiring substantial equity positions in U.S. airlines in order to strengthen their presence in the U.S. marketplace, and provide needed feed traffic over their U.S. gateways to foreign destinations. It appears to us that airlines such as KLM and SAS have acquired large equity interests in U.S. carriers in order to position themselves for that time in the future when U.S. laws restricting foreign ownership are further relaxed, when cabotage is permitted, and when they can then fully enter interior U.S. markets. It is our belief that the Department must carefully examine each foreign investment on a case-by-case basis. The Department should not permit foreign carriers to obtain significant equity positions in U.S. carriers (that is, no more than 30%-35% voting and non-voting combined. . . or even less) if the home countries of those foreign carriers have adopted restrictive policies that prevent U.S. carriers from freely serving markets to and within their countries. We are concerned that as equity participation increases, foreign airlines will substantially control U.S. airlines. Our primary concern is not the creation of real or potential competitors for Delta in the U.S. marketplace but rather the consequences these ownership stakes will have on U.S. Government initiatives to liberalize bilateral agreements. For example, if British Airways or Japan Air Lines were allowed to make substantial investments in U.S. airlines, there would be little, if any, incentive for their governments to liberalize their highly restrictive bilateral agreements to permit Delta and other U.S. carriers to compete on a fair and equitable basis with their airlines.

Mr. Chairman and Members of the Subcommittee, that concludes my testimony. I shall certainly be pleased to respond to your questions.

| 1989 U.S. - LONDON PASSENGERS BY U.S. FLAG CARRIER BREAKDOWN BY U.S. GATEWAY UTILIZED | | | |
|---|---|---|---|
| TOTAL U.S.-LONDON TRAFFIC FLOWING OVER U.S. GATEWAYS TO LONDON: | | 4,257,056 | |
| GATEWAY | TOTAL US-LONDON USING THIS GATEWAY | PERCENT OF TOTAL | US-FLAG CARRIERS POST ACQUISITIONS |
| New York, NY | 1,098,077 | 25.79% | UA/AA* |
| Los Angeles, CA | 330,074 | 7.75% | UA*/AA* |
| Boston, MA | 384,957 | 9.04% | AA/NW* |
| Miami, FL | 379,446 | 8.92% | AA*/PA* |
| Newark, NJ | 245,820 | 5.77% | UA/AA/CO* |
| Chicago, IL | 130,276 | 3.06% | AA* |
| Atlanta, GA | 197,130 | 4.63% | DL* |
| Houston, TX | 148,808 | 3.50% | CO* |
| Minneapolis, MN | 152,087 | 3.57% | NW* |
| Dallas/FW, TX | 198,509 | 4.66% | AA* |
| San Francisco, CA | 135,388 | 3.18% | UA* |
| Washington, DC | 166,855 | 3.92% | UA* |
| St. Louis, MO | 118,927 | 2.79% | AA** |
| Detroit, MI | 72,734 | 1.71% | PA |
| Charlotte, NC | 101,425 | 2.38% | US* |
| Cincinnati, OH | 117,928 | 2.77% | DL* |
| Denver, CO | 75,712 | 1.78% | CO* |
| Seattle, WA | 94,840 | 2.23% | UA* |
| Baltimore, MD | 73,866 | 1.74% | AA** |
| Philadelphia, PA | 34,199 | 0.80% | AA |
| *Carrier's hub or major service point. | | | |
| **Moveable gateway. | | | |
| Post Acquisition AA and UA will serve 79.66% of all US traffic to London. | | | |
| Source: DOT Service Segment Data, CY 1989 | | | |

| U.S. CARRIER LONDON SERVICE AUTHORITY AFTER TRANSACTIONS | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | UA | PA | AA | TW | CO | DL | NW | US |
| Northeast | IAD*<br>JFK<br>EWR | | BOS<br>JFK*<br>EWR<br>PHL | | EWR* | | BOS* | |
| Southeast | | MIA* | BNA**<br>MIA*<br>RDU** | | | ATL* | | CLT* |
| North Central | | DTW | CHI* | | DEN* | CVG* | MSP* | |
| South Central | | | DFW* | | HOU* | | | |
| West Coast | LAX*<br>SEA*<br>SFO* | | LAX* | | | | | |
| **If AA moves BWI and STL routes. | | | | | | | | |
| *Carrier's hub or major service point. | | | | | | | | |

*March 15, 1991.*

HON. WENDELL H. FORD,

*Chairman, Aviation Subcommittee, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, D.C.*

Dear Senator Ford:

This is in response to your letter of February 27, 1991, submitting some additional questions from Senator Hollings in relation to my testimony on February 19 before the Aviation Subcommittee. Because of certain activities here in Atlanta at Delta Air Lines, your staff agreed that I could submit this information after the suggested March 11 submission date. I appreciate your and the staff's flexibility in this respect, and we are certainly pleased to respond to these and any additional questions that you might have.

Two questions were posed concerning foreign carriers:

*Question 1:* Is there a need to mandate that foreign carrier directors on the boards of U.S. carriers recuse themselves from specific types of information? Is this a plausible means to guard against potential competitive problems?

Answer: To the extent that representatives of foreign air carriers are allowed to sit on the boards of U.S. carriers, we feel strongly that they should not have access to information concerning service or pricing activities by the U.S. carriers which are or could be competitive with the foreign air carrier involved. Similarly, such directors should not be permitted to participate in policy formulation or decision-making concerning such matters. Hence such representatives should recuse themselves in every circumstance where the information to be revealed could involve a potential or real competitive conflict. As a general matter, the Department of Transportation has imposed such restrictions, and Congress should codify this practice.

While helpful, such restrictions, even if codified, would be difficult to enforce. This enforcement problem reinforces the need to preserve tight limitations on levels of foreign investment and equity ownership in U.S. carriers in order to protect against competitive problems. Moreover, if foreign air carriers are allowed to obtain a substantial equity ownership in a U.S. carrier, particularly substantial voting equity, significant control of the U.S. carrier could still result, even with a recusal requirement.

It is therefore Delta's basic position that for the present time, at least, there should be no significant increase in the current 25% limitation on foreign ownership (foreign air carrier or other foreign ownership) of the voting stock of U.S. carriers, and that increases above that level in ownership of overall equity including non-voting stock, should be examined on a case-by-case basis (perhaps with the aid of new legislative guidelines on the question of overall equity limits) in order to insure that in no case is there foreign control of a U.S. carrier; that competition is not compromised; and that ownership does not rise to a level which undermines this country's efforts to obtain liberal bilateral relationships with foreign countries.

*Question 2:* Once a foreign carrier invests in a U.S. carrier, many claim that the host country's incentives to negotiate a more liberal bilateral agreement will change. All of you will be affected if this claim is true. How do you anticipate these changes will affect your carrier's ability to serve that country and what steps should Congress be looking at to address this potential problem?

Answer: Investment per se by a foreign airline in a U.S. carrier does not mean that the host country will lose all or most of its incentive to negotiate a liberal, open entry bilateral agreement with the United States. A foreign country's incentive to negotiate a liberal agreement depends upon the level of foreign carrier investment. If the investment is of such magnitude as to result in control of the U.S. airline (and control can exist even when ownership of voting stock is well below 50%, if other equity ownership or conditioned debt is also permitted), there would be no incentive for the foreign government to negotiate a liberal agreement.

Delta would be adversely affected in circumstances where the United States has forfeited its leverage to a foreign country that has a restrictive bilateral agreement. Many of the countries that Delta would like to serve do not now have agreements that permit Delta to provide new international services without obtaining a change in the bilateral agreement. An excellent example is the U.S.-U.K. Air Services Agreement.

Delta, and other U.S. airlines, would be adversely impacted if access to the U.S. interior markets through control of U.S. airlines were given unilaterally to foreign carriers whose governments practice protectionist policies and refuse to liberalize restrictive agreements that prevent effective U.S. airline competition.

The congressional action needed is, again, preservation of tight limitations on levels of foreign investment in voting stock of U.S. air carriers (the present 25% limit or no more than a small increase in that allowable percentage) and perhaps new statutory limits on overall foreign equity investment in U.S. carriers.

The following question was also posed concerning the route transfer process:

*Question 3:* You have indicated that the process employed for the route transfer cases is not satisfactory in that it does not permit a look at the competitive consequences of a transfer, particularly the TWA-American deal for the U.S.-London routes. Yet, DOT precedent suggests that DOT should not treat this case any different from the United-Pan Am deal. Why do you believe that this case deserves a different set of procedures? Is your real concern that, if the deal goes through and the bilateral talks with the United Kingdom permit the substitution of American and United, you may be

frozen out of London's Heathrow market? If so, shouldn't we be addressing that aspect of the problem, rather than the specific TWA-American deal?

Answer: Delta is not opposed to the buying and selling of international route authority, and our testimony was not intended to say that the current procedures do not give any consideration to the competitive consequences of proposed transfers. Delta's basic position is that the underlying, pro-competitive principles which are followed by the Department of Transportation in initially establishing new international routes in restricted-entry markets—principles which insure multiple U.S. carrier competition and multiple U.S. gateway competition—should also be followed in international route transfer cases in order to be sure that transfers do not undermine such competition. In uncomplicated transfer situations expedited procedures may be appropriate. But when one or more simultaneous transfers involve numerous markets and massive realignments in limited-entry situations—as in the United-Pan American and American-TWA transactions—more elaborate procedures are required to be certain U.S. carrier competition is preserved.

Delta filed a motion with the Department of Transportation seeking an oral evidentiary hearing for both the United-Pan American and American-TWA transactions. The fact that the Department decided to approve the United-Pan Am transfer without hearing does not diminish the need for a thorough examination of the competitive and public interest issues associated with the TWA-American route transfer. This need is spelled out in detail in Delta's attached Answer to Joint Application, dated January 18, 1991.

The TWA-American transaction is significantly more complex than the United-Pan Am transfer. American has already obtained authority from the government to operate three routes to London (Dallas/Ft. Worth, Miami, Chicago). The transaction with TWA would transfer an additional six U.K. routes, and give American a total of nine London routes. By contrast, the United-Pan Am transaction involved only five U.S. -London routes. Additionally, the transfer by TWA would give American access to nearly 50% of U.S. traffic flowing over gateways to the United Kingdom. The TWA-American route transfer would place in the hands of a single carrier the ability to operate to London from more major U.S. hubs than any other U.S. carrier; to dominate major areas of the U.S. insofar as U.K. service is concerned; and to divert heavily from other carriers, like Delta, with limited routes to the U.K. out of only one or two U.S. gateways.

Delta is not concerned about being frozen out of London's Heathrow market. Delta operates to Gatwick and has no present plans to serve Heathrow. Rather, Delta is concerned that the combination of the two transfers and the excessive price paid by the U.S. government for allowing American and United access to Heathrow, would freeze Delta out of any future expansion of service between the United States and London. In order to help avoid this sort of anti-competitive effect, Delta argued that the agreement with the British should not be concluded prior to a final decision on both of the two transfer transactions that were raising the Heathrow Airport question.

Unfortunately, the U. S. Government ignored Delta's pleadings and first approved the United-Pan American agreement as filed without awaiting conclusion of the U.S. -U.K. negotiations, and then paid excessive and enormous concessions to the British Government in order to secure successor rights at Heathrow for United (and presumably American), to assure that two financially troubled airlines would be able to obtain proceeds from the sale of their London routes. The British have obtained so many new rights through these concessions that the U.K. will have little future incentive to liberalize its bilateral aviation agreement with the United States, or to establish new rights (e.g. Orlando-London) for other U.S. carriers like Delta. The Heathrow issues as played out in the now-concluded negotiations have therefore exacerbated the potentially serious anti-competitive effects of these two route transfers. Other U.S. carriers will be placed at a severe competitive disadvantage if the American-TWA agreement is now approved without substantial conditioning. The processing of that transfer application is the only step left in which U.S. carrier competition to and from the U.K can reasonably be protected.

Simultaneous consideration of these two massive route transfer proposals, using procedures that would permit complete examination of all competitive ramifications, prior to concluding the bilateral negotiations, would have been the soundest course. But, at the least, full exploration of the most troublesome of the transfers, the American-TWA proposal, must still be undertaken. No other course of action remains to protect other U.S. carriers who operate U.S.-U.K. services.

Thank you for opportunity to testify and to respond to Senator Hollings' questions. We would be pleased to respond further if there are other questions, and to work with the Committee if legislation is developed to address these issues.

Sincerely,

JAMES W. CALLISON, *Senior Vice President.*

Senator FORD. Thank you. Mr. Beauvais?

## STATEMENT OF EDWARD BEAUVAIS, CEO, AMERICA WEST AIRLINES, PHOENIX, AZ

Mr. BEAUVAIS. Thank you, Mr. Chairman, Senator McCain.

I would like to thank you for this opportunity to present the views of America West. And I would like to express my appreciation for your diligent efforts on behalf of competitive industry over the past 4 years and as we move forward in the future.

While the subjects of this hearing are foreign investment and controlling the airline industry and the current Governmental policy regarding buying and selling of international routes, I believe we must step back and examine the state of the industry before we address these issues.

The airline industry finds itself at a cross roads. One road leads in the direction of a consolidation policy. Nothing is done to change the current environment. Consolidation continues and the result is three, maybe four airlines. To travel that road one must be right about the competitive environment that will result. Because if one is wrong, it will be too late to fix it.

I might emphasize that this industry was already concentrated when it was deregulated in 1978. There were 24 airlines at that time. There have been 22 mergers that have come before DOT since 1984 and they were all approved.

The other road leads to the development of Government policy that will provide the frame work for a healthy competitive environment or at the worst be neutral on industry consolidation.

It is hard to imagine that there would a serious debate on which direction to chose. Yet, incredibly that is precisely what is occurring.

Many assert that in this era of internationalization what we need are a few strong competitors to take on our overseas rivals. Therefore, we must sacrifice some domestic competition and run the risk of poor service and higher fares to accommodate this policy. This belief puzzles me. We have an industry that has been hardened by deregulation for over 12 years.

As the rest of the world deregulates, a healthy competitive U.S. industry with numerous competitors should be an advantage, not a disadvantage.

I also wonder how anxious other nations will be to open up their system to the U.S. giants created by consolidation policy. In a recent Wall Street Journal article concerning the Heathrow Airport controversy, Lord King, chairman of British Airways, stated that without government protection, a flock of British sparrows would not stand much of a chance against the onslaught of American eagles. And I might add that British Airways is quite well-known as being the most aggressive foreign flag carrier outside of the U.S.

I suspect that this view will be shared in most corners of the globe and we will ultimately have a less competitive international air transportation system.

In light of the above, let us look at the subjects of today's hearing, increased foreign investment, especially done a reciprocal basis only favors the strong. Those abroad with money to invest will most likely not invest in carriers that the U.S. Government, through its consolidation policy, has already decided are losers. When Government officials publicly announce that only four carriers are needed, that sends a strong message.

In terms of investment opportunity abroad, only the strongest domestic carriers have the resources to do so. As I have alluded to before, I find it unlikely that foreign governments will allow their airlines to get carried off by the American eagles and much more likely that some form of arrangement will be made which likely will not have competition in the consumer's best interest as a central component to the deal.

I heard earlier an analogy to the automobile industry. I find it very curious that we have three manufacturers in the U.S. in a very large market and 11 automobile manufacturers in Japan. It is my understanding of that industry those 11 do very well.

In our industry in the U.S., the U.S. domestic market represents two-thirds of the world market. And we are talking about possibly just four airlines playing the major role in providing service in the largest portion of the worldwide aviation market. It does not make any sense to me as far as I can see if there were 24 airlines in deregulation, there should be far more than four in the U.S. that are highly competitive and efficient and, believe me, they can handle competition with their foreign counterparts.

Regarding the buy-sell policy on international routes, it is hard to figure why that would be advocated given the dismal results of the buy-sell policy regarding slots.

As can be seen with the Eastern liquidation, the big carriers get bigger and the smaller get nothing as sales to the highest bidder, competition be dammed, become the buy words.

Pursuing this course helps drive consolidation and extinguish any hope of new entry. And if you look at the results of the past route sales, Braniff, Eastern, and Pan Am, it is not an encouraging track record.

Mr. Chairman, if this committee wants to preserve and enhance a competitive industry, if it wants to assure that the benefits of deregulation are preserved for the traveling public, for tourism, which is our nation's number two industry, for aviation manufacturing, which leads our international trade effort, and for the countless communities across the nation that need adequate aviation service for economic development, it must act now. Soon there will be no actions left to take. And it is not too late to reverse this direction in our industry.

Thank you very much.

[The statement follows:]

STATEMENT OF EDWARD R. BEAUVAIS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, AMERICA WEST AIRLINES, INC.

Mr. Chairman and Members of the Subcommittee, I am Edward R. Beauvais, Chairman and Chief Executive Officer of America West Airlines, Inc., a post deregulation airline that began operations seven and one-half years ago. The Subcommittee is to be commended for conducting these important hearings, and we very much appreciate the opportunity to testify today on the subject of foreign investment in U.S. airlines and the subsequent control questions, as well as the equity and efficiency of the current process by which international route authority is transferred.

BACKGROUND OF AMERICA WEST AIRLINES, INC.

By way of background, America West is one of the two remaining post-deregulation carriers. We began operations as a new entrant airline in August 1983 with 500 employees and three Boeing 737-200 aircraft operating to and from our Phoenix hub and the cities of Los Angeles, Kansas City, Colorado Springs and Wichita.

Since that time, we have grown dramatically. America West presently operates a fleet of 104 aircraft, including Boeing 7475, 757s, and 7375 and deHavilland Dash 85. We recently entered into an agreement to acquire up to 118 Airbus A320s, and we will operate 16 of the new aircraft by mid-1991.

The number of destinations we serve has increased from three to 59. Our operations extend throughout the mainland United States to Hawaii and Canada, and we recently inaugurated service to Japan.

Because of our highly motivated and involved work force, America West has been able to grow into an airline of national scope, with the Department of Transportation categorizing us, effective January 1990, as a "major" carrier. Our available seat miles (ASMs) have grown from 2.4 billion in 1984, our first full year of operation, to 18.3 billion in 1990. Our revenue base has increased from $122.6 million in 1984 to $1.3 billion in 1990. In 1990, America West enplaned 15,624,060 passengers—a 13,226,060 million passenger (more than sixfold) increase from the 2,398,000 enplaned in 1984.

We at America West believe that one of the important reasons that we have been able to survive, grow and prosper in today's competitive environment is our underlying management philosophy. That is, we stress the individual value of all employees and the importance of the role of every individual who works for America West in developing a profitable organization that strives to meet the needs of the traveling public.

Employee stock ownership is the cornerstone of this philosophy. Each America West employee is a shareholder. In addition, all employees participate in our incentive stock option plan which gives each one the opportunity to increase his or her holdings in the company through good performance. For many employees, their first experience with stock ownership is with America West. Through their participation, they learn that their financial security is directly tied to the financial success of their company. This employee ownership creates a unique motivational tool for employees who work with limited direct supervision and constant customer contact.

America West also provides a very liberal profit sharing program, which is, again, designed to provide incentives to create a profitable organization by delivering quality customer service.

In keeping with the emphasis on employee participation, America West has also developed a union-free work place that provides for direct employee participation through a variety of committees staffed by employee-elected representatives. These committees establish their recommendations for work rules, pay procedures and the like.

Working as a partner in economic development with the Phoenix community, America West's service has helped transform the community from the 14th largest O&D market in the United States in 1983 to the 10th largest in 1988. Indeed, Phoenix has become the fastest growing transportation center in the U.S., with Phoenix O&D passenger levels growing at an annual rate of 11.4 percent (6.9 million annual O&D passengers in 1983 to 13.8 million annual O&D passengers by year-end second quarter 1989).

The role played by America West in this growth was significant. Of the 6.9 million increase in annual O&D passengers, 4.4 million, or 64.3 percent, traveled on America West. In providing a quality, safe, on-time product to the community of Phoenix, America West has participated significantly in the community's economic development. Using data provided by the community, America West estimates that its activities in the Phoenix metropolitan area added $6.4 billion to Phoenix' economic development during 1988. America West has created nearly 9,000 'jobs in the Phoenix area, and America West's payroll alone for the Phoenix metropolitan area exceeded $198 million in 1989.

A similar record of cooperation in economic development exists between America West and Nevada, particularly at Las Vegas, and, as at Phoenix, America West has earned the largest market share of any carrier serving Las Vegas.

Of the 62 nonstop jet destinations at Phoenix, America West provides service in 42, or 67.7 percent. Since America West first inaugurated service in 1983, the number of Phoenix markets with jet service has increased by 25, or 67.6 percent, going from 37 jet destinations in 1983 to 62 today. A similar trend is seen at Las Vegas. Since 1983, the number of markets with jet service has increased by 12, or 40.0 percent, going from 30 in 1983 to 42 jet destinations today. America West provides service in 30, or 71.4 percent, of these markets.

As to the future growth of our domestic system, we intend to continue to expand our Phoenix and Las Vegas hubs, with additional frequencies to cities that we already serve and the addition of new cities to our existing system, particularly along the West Coast where we see significant opportunities for growth. In addition, we intend to continue in our efforts to expand our route network to the East, including slot restricted airports, and eventually to the South as we take delivery of new aircraft over the next several years.

Insofar as America West's international aspirations are concerned, the Secretary of Transportation's Task Force on Competition in the U.S. Domestic Airline Industry specifically recognized the increasing importance of international routes to U.S. carriers, noting that, while only 22~ of the nine major air carriers' 1988 operating revenues were earned in international markets, these international markets accounted for 34~ of their 1988 operating profits. The study also pointed out that revenues and profits from international operations are important not only in and of themselves, but also, and perhaps more importantly, to provide carriers with strength to compete effectively domestically.

We at America West have recognized the important role that international service can play, and have been taking the necessary steps to position ourselves to provide such service. In this regard and while service to Europe is in our plans, our principal focus has been upon Pacific Rim service for several reasons:

First, America West is essentially a Western U.S. airline, with the bulk of our service and our two hubs being located west of the Mississippi.

Second, growth in passenger demand between the United States and the Pacific has nearly doubled since 1985, growing at an annual rate of 18.7 percent, far faster than to other parts of the world.

Third, the Western United States is a particularly popular tourist destination for Pacific Rim-originating passengers. Indeed, based on statistics provided by the U.S. Travel and Tourism Administration, five of the six most popular vacation destinations for Japanese travelers are in the West and we serve all five of them — Los Angeles, San Francisco, Disneyland, Las Vegas and the Grand Canyon.

Fourth, a strong community of interest has begun to develop between many of the destinations on our system with a significant number of high-technology companies and similar destinations on the Pacific Rim.

Finally, the inauguration of our Hawaiian service in November 1989 has permitted America West to begin the development of a mini-hub at Honolulu to use as a jumping-off point for international service to various Pacific Rim destinations. And, as these markets develop over the next several years, we will be able to provide nonstop service to these points, utilizing our 747-400 aircraft that are scheduled for delivery in the mid-1990's.

As I indicated previously, America West began service to Nagoya, Japan recently, and we intend to build on this Pacific Rim service, offering flights from our mini-hub in Honolulu to various destinations in the Pacific such as Hong Kong, Taipei, Sydney, and Seoul as well as any additional points in Japan that may become available.

EVOLUTION OF THE AIRLINE INDUSTRY SINCE THE PASSAGE OF THE AIRLINE DEREGULATION ACT

As is discussed in the study prepared by the Secretary's Competition Task Force, 99 percent of the domestic traffic revenue passenger miles was carried by the 19 trunkline and local service carriers in 1978, the year the Airline Deregulation Act was passed. And, while this percentage declined from 1978 to 1984, the 22 mergers and acquisitions approved by the Department of Transportation during the period 1985 through 1988 has resulted in a situation in which the top 5 carriers accounted for 74~ of all domestic RPMs in 1988, or 5 percentage points higher than before deregulation. Task Force Study, "Industry and Route Structure", Table I-5. And, as may be seen from Exhibit A that was published in the Aviation Daily on January 29, 1991, American, United, Delta and Northwest dominated the industry on a systemwide basis in 1989 and 1990.

In recent years and based, once again, on information provided in the D.O.T. study, every major carrier expanded its hub-and- spoke operations by establishing new connecting complexes at most large F.A.A. hubs (excluding several coastal cities) and several medium F.A.A. hubs. The result has been a large increase in carrier concentration at such hubs. In July 1988, 17 of the 27 large hubs had only one or two competitors with significant shares, compared with three that had only one or two competitors in 1979. At six large hubs today, 75 percent or more of departures or enplanements are by a single carrier, and these hubs are far more concentrated than the most concentrated hub in 1979. Id., Table I-9.

While there may have been a general decline in citypair concentration from 1979 to 1988 in the top 1,000 markets, the quality of competition in these markets is, quite significantly, related to the specific carriers providing the competition rather than the number of carriers in any given market. Thus, as may be seen from Exhibit B, which analyzes the passengers carried and fares charged in the top 1,000 city-pair markets for the year ended third quarter 1989, the three largest U.S. carriers, Delta, American and United, are able to charge fares in those top 1,000 markets that are significantly higher than the average industry fares in these markets.

Exhibit C provides further confirmation of the market power of American, United and Delta. In this regard, the column on the far right of each table of this exhibit depicts the relative advantage that a particular carrier has against the other carriers with which it competes in these 1,000 markets. As may be seen from the three charts related to American, Delta and United (Exhibit C, pages 1-3), American is able to achieve a fare premium against each carrier with which it competes, Delta is able to achieve a premium against each carrier except American, and United is able to achieve a premium against each carrier except American and Delta.

And, as may be seen from Exhibit D, it is the identity of the carrier operating a particular hub, not simply that it is a hub, which is critically important in determining the level of fares that are actually paid by U.S. consumers[1]

Finally, Exhibit G depicts what happens when two of the largest carriers "compete" on a head-to-head basis. During the course of the 1990 U.S. -Japan Gateways Proceeding, Docket No. 46700, America West prepared several exhibits setting forth the manner in which the various applicants in that case, including American, Delta and United, compete at their hubs, including O'Hare and Dallas/Ft. Worth. As may be seen from Exhibit G, American and United each charge fares in the O'Hare markets that are higher than the industry average fare and the fares charged by other carriers at O'Hare, and, as may be seen from that same exhibit, it is only the competition provided by Midway that has kept the fares as low as they are. Similarly, American's and Delta's fares in the DFW markets are higher than the industry average fare and the fares charged by other carriers at DFW, and it is only the competition provided by Southwest that has kept the fares as low as they are. See "Airline Deregulation—Trends in Airfares at Airports in Small and Medium-Sized Communities" (Nov. 1990), a G.A.O. report that discusses the favorable effect that the entrance of low-cost airlines, such as America West and Southwest, have on fare levels.

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[1] We would point out that Michael Levine, one of the early proponents of airline deregulation, has written an extensive article discussing the workings of airline markets since deregulation entitled, "Airline Competition in Deregulation Markets: Theory, Firm Strategy, and Public Policy," 4 Yale J. on Regulation 393 (1987) in which he recognized the failure of the theory of contestability in the airline industry. In addition, Professor Severin Borenstein, America West's witness in the U.S.Air-Piedmont Acauisition Proceedina, has written two articles (which are attached as Exhibits E and F for the convenience of the Subcommittee) examining airport dominance and market power in the U.S. airline industry and the competitive advantages of dominant airlines.

We believe this data demonstrates that there is a direct relationship between the increasing level of concentration in the U.S. air carrier industry and the fares that are actually charged to the traveling public. And, because of this relationship, it is critically important for policymakers to focus on the size and market power of the larger carriers as well as the various barriers to entry that exist in making judgments as to the appropriate administrative and legislative actions that should be undertaken to assure the proper functioning of a fully competitive industry.

EVENTS OF THE PAST SEVEN MONTHS HAVE HAD A SIGNIFICANT ADVERSE EFFECT ON THE U.S. AIRLINE INDUSTRY

Over the past seven months, the airline industry has been buffeted by three significant developments beyond its control, the consequences of which, if not addressed in the near future, threaten the viability of the U.S. air carrier industry. First, as a result of the invasion of Kuwait by Iraq on August 2, 1990, jet fuel prices doubled for America West, going from approximately 60 cents per gallon before the invasion to $1.20 per gallon in October. Significantly, this incredible increase in prices occurred only in jet fuel prices, with gasoline and heating oil prices, the other two significant oil products, lagging far behind. Indeed, as may be seen from Exhibit H, which was prepared by the Energy Department, jet fuel spot market prices increased more than 41 percent from August to November, whereas the spot market prices for West Texas intermediate crude oil, wholesale gasoline, and No. 2 heating oil increased by only 24-26 percent. And, notwithstanding requests by various carriers that the Government take steps to ameliorate this disproportionate effect on the airlines, none of these recommendations was implemented because, it was said, there was not a "consensus" within the industry as to which particular approach should be pursued. While the prices for jet fuel have come down, the financial effects of these high fuel prices on the carriers during the third and fourth quarters were quite serious, and today's jet fuel prices are still approximately one-third higher than the prices before the invasion. They remain subject to upward spikes driven by the uncertainties related to the Persian Gulf war.

Second, the adverse effects of these increased jet fuel prices came on top of a declining U.S. economy which was already resulting in reduced traffic levels for the industry. Thus, throughout the later part of 1990, traffic continued to fall off, as U.S. businesses and discretionary travelers simply traveled less in the face of the overall softening in the U.S. economy.

The final, and perhaps today the most pernicious effect of the war in the Persian Gulf is the reduction in U.S. and, indeed, worldwide traffic as a result of governmental and business policies restricting air travel as well as the decision of discretionary passengers not to travel in the face of concerns related to terrorist threats. And, just a couple of weeks ago, as a result of security concerns, the U.S. Postal Service determined not to ship mail over 16 ounces in weight by air, thus depriving U.S. airlines of an estimated $1 billion in annual revenues.

The combined effect of these three factors is that airline costs have increased significantly and traffic has fallen substantially for all carriers. While all U.S. industries have undoubtedly been affected to an extent by the events of the past seven months, it is beyond question that the adverse effects on the U.S. airline industry have been disproportionate to the effect on other U.S. industries and that, if these effects continue, the continued ability of that industry to remain viable both domestically and internationally will be seriously compromised.

ADDRESSING THE CONSEQUENCES OF INCREASING CONCENTRATION, DECREASING COMPETITION AND THE PERSIAN GULF WAR

As is apparent from this discussion, certain of the difficulties facing the U.S. airline industry are of a short-term nature while others are more long-term in nature, and, while certain of the longer-term issues clearly affect different carriers in different ways, there can be no dispute that the events of the past seven months affect all carriers in very similar ways. Indeed, the president of ATA described the threat facing the U.S. industry in the following manner:

"The industry is in unparalleled crisis - it has never experienced the kind of threats that it faces today to its stability and financial viability. The capital structure of the entire U.S. airline industry is in the process of being systematically destroyed, whether we are talking about the wealthiest or financially strongest airlines or some of the weakest - they are all hemorrhaging cash to pay their fuel bills, and it is weakening even the longer-term ability of the strongest carriers to continue to re-equip and provide a high level of service across the board in the future. It's weakening the weak in a very threatening way, and it's weakening even the strong in a serious way."

In such an environment, any proposed administrative or legislative action to improve the financial conditions of the industry and/or to enhance industry competition must be carefully considered to assure that the proposed solution will effectively address the problems so identified and that short-term solutions to a problem do not in and of themselves create more serious long-term problems.

In the short-term, the principal problems facing the industry are coping with the financial effects of the high fuel costs paid during the fall, the elevated level of fuel costs that persist today and are likely to recur until the end of the hostilities in the Persian Gulf and the decline in traffic resulting from the recession in the U.S. economy and, more importantly today, the reaction of the traveling public to the fear of terrorist activity.

Last fall, America West and other carriers urged the Departments of Transportation and Energy to consider various alternative proposals, including "monetization" of the Strategic Petroleum Reserve and retention of the airline ticket tax, to provide the airlines with the wherewithal to deal, in one way or another, with high jet fuel prices.

Insofar as the decline in traffic is concerned, it is not reasonable for the airline industry to expect relief from a decline in traffic resulting from the general downturn in the U.S. economy. On the other hand, the significant reductions in traffic that are presently being experienced as a consequence of the threat of terrorism associated with the war are a direct result of national policy. Moreover, if an actual terrorist incident were to occur at an airport or on an airplane, there will be a further and perhaps more serious deterioration in traffic. Under these circumstances, America West submits that it is incumbent upon the Federal government to develop a program that will permit the airline industry to cope with the effects of higher jet fuel prices and significantly reduced traffic levels. In this regard, what the industry needs is a program that will provide a short-term infusion of cash that can be repaid over a period of time in order to offset the short-term consequences of our national policy to enforce the U.N. 's resolutions related to the invasion of Kuwait.

While there are many that argue that changing the rules regarding foreign investment in U.S. carriers and permitting financially weak airlines to sell international routes are the "solution" to many, if not all, of these problems, careful evaluation of these proposed changes reveals that they are not the "panacea" claimed by their advocates.

FOREIGN INVESTMENT

Turning initially to changing the law concerning foreign investment in U.S. air carriers, America West urges that the Congress thoroughly consider the ramifications of actions that could ultimately lead to the loss of control of our domestic air transportation system, which, unlike those of other nations, is the nation's primary form of mass transportation and is responsible for the carriage of more than onehalf of all passengers traveling by air throughout the world.

Indeed, before opening up the most lucrative domestic market in the world to foreign air carriers and other foreign investors, several important questions should be addressed and resolved. First and most importantly, are the competitive problems presently facing the U.S. airline industry susceptible of solution on a long-term basis by the mere infusion of foreign capital, or are other more fundamental structural and competitive problems the cause of these difficulties and the proper focus of attention?

Second, careful consideration should be given to who those foreign investors might be. The airline industry has had experience with those individuals who have been motivated by its well known and attractive cash flows and did not have the long-term interest of the industry in mind. In addition, one must not lose sight of the fact that the present weak dollar and low airline equity prices combine to make such purchases an attractive "play". Thus, while the short-term interests of such financiers may well be satisfied by such a change in policy, it is not at all clear that the long-term interest in maintaining a viable U.S. air transportation system would be well- served by allowing such individuals increased financial participation.

If, on the other hand, the "new" investors were foreign air carriers, there is a serious question as to whether the current competitive environment would be maintained, much less enhanced. As the Department of Transportation knows all too well from numerous bilateral negotiations that have been adversely influenced by a dominant air carrier in a particular foreign country that is not eager to compete, most foreign air carriers are not aggressive competitors (particularly with respect to price) — a not inconsequential consideration when improved competition is one of the expressed goals of those who advocate revision of the foreign investment laws.

Third, the existing bilateral agreements between the U.S. and other countries represent a careful balancing of benefits between the two countries. Simply permitting a carrier in a foreign country to "buy" its way into the lucrative domestic U.S. market by a unilateral change in U.S. law will surely undermine the integrity of those agreements.

Fourth, even if one were to assume that a change in U.S. law were not to go into effect until a similar opportunity existed in the other country, the effects of such a change on competition in the U.S. must nevertheless be evaluated. As a consequence of the various barriers to entry that exist in the U.S. today, such as the substantial financial benefits that accrue to U.S. CRS owners, only the very largest U.S. carriers will realistically be able to engage in the reciprocal purchase of an interest in, or control of, a foreign airline. If there is any hope for maintaining a competitive situation in the U.S., great care should be taken so as not to give these larger carriers yet another competitive advantage.

Finally, the Congress and the Executive Branch must each ask itself whether it is in the national interest to permit foreign control of the vital elements of our national infrastructure — a question that takes on added significance with the present callup of our nation's civil reserve air fleet. We raise these questions to point out that a change in this policy demands a thorough analysis of possible outcomes. This precludes the possibility that foreign investment is an answer to the industry's problems in the short term. By the time any such policy change can be considered and implemented, it is quite likely that a good deal more consolidation will have taken place.

Insofar as allowing financially weak airlines to sell international routes as a means of addressing the financial problems of the weaker carriers, several important policy considerations suggest that such transfers raise serious public interest concerns. First and perhaps most importantly, such sales have not assured the continued existence of the financially weak airlines and, indeed, may, in particular instances, substantially diminish the ability of a carrier to remain an effective competitor in the airline industry. Thus, the sale of Eastern's profitable South American route authority to American, while permitting Eastern to subsidize its otherwise unprofitable operations for a while longer, did not enhance Eastern's long-term viability. Similarly, while Pan American's sale of its profitable Pacific route authority to United permitted Pan Am to continue to operate, it finds itself, once again, in serious financial difficulty and the domestic airline industry has been left to deal with United's growing dominance in the Pacific, a presence that United is now seeking to replicate through its purchase of Pan Am's profitable London routes. In fact, as America West has pointed out in responding to the Department's show cause order related to the United-Pan American route transfer, there is a serious question as to whether Pan Am, by the very sale of its core London route authority, will, as a consequence of the sale itself, not be able to remain an effective competitor in the airline industry. Similarly, stripping TWA of its London authority may well compromise its ability to remain as an effective competitor.

Second, while the Department, in awarding limited entry routes in comparative hearings, generally chooses among several competing applications on the basis of a wide range of public interest factors, it has adopted a policy in route transfer proceedings of not permitting the filing of competing applications for one or more of the routes that are proposed to be transferred, thus precluding, by the manner in which the proceeding is structured, any ability to consider the full range of public interest considerations raised by such transfers. Indeed, one must ask the question whether, if the route authority that is presently the subject of the United-Pan Am or American-TWA proposed route transfers were the subject of a fully litigated route proceeding, D.O.T. would seriously consider awarding all of the routes to only one carrier? The question, of course, answers itself, but that is precisely what will happen if the Department determines to approve each of these route transfer applications.

Third, the Department goes to great lengths in comparative route proceedings to justify its decision on the basis of specific public interest considerations specified in Section 102 of the Federal Aviation Act of 1958, as amended. In addition, Secretary Skinner stated in a June 1989 letter to airline presidents that one of the criteria to be evaluated in route transfer proceedings is whether the proposed transfer undercuts the important public benefits that the Department sought to achieve by awarding the route in the first place. Yet, the Department's decisions authorizing the transfer of these routes fail in most instances to fully evaluate these considerations, thus, once again, precluding consideration of the benefits of competitive alternatives.

Fourth, it is no answer to argue that the carrier purchasing the route or routes would be a more effective competitor than the financially weak carrier that is proposing to sell its routes. That "strawman" argument could, in all likelihood, be made with respect to any of the applicants that would be likely to apply for the authority to be transferred if it were to be reawarded in a comparative route proceeding.

Fifth, many of those route transfers, which involve purchases by the already large carriers, adversely affect industry balance and competition in the domestic airline industry.

As mentioned previously, the Secretary's recent Airline Competition Study made note of the high profitability of international routes and emphasized the importance of these profits to effective domestic competition. In this regard, the proposed transfer of Pan Am's and TWA's London authority to United and American, respectively, and the proposed transfer of Hawaiian's Australian and Japanese authority to one of the two dominant U.S. carriers in the Pacific, Northwest, would, without doubt, have serious and long-term adverse competitive consequences in the Atlantic, Pacific and domestically. Other carriers would be foreclosed from competing for traffic flows and the resulting revenue from these routes. As to each of these proposed transfers, there are other carriers that are fit, willing, able and eager to provide these services.

Finally, only the large and financially strong carriers are in a position to pay millions of dollars for such route authority. Thus, it should come as no surprised that it is the owners of the "cash cow" computer reservation systems, United and American, and the beneficiary of the recent change in D.O.T. policy regarding foreign investment, Northwest, that have proposed to purchase these routes and, in the case of Northwest, take a significant ownership position in Hawaiian.

This phenomenon of the rich getting richer does not, of course, have to be the case. Thus, the Department could develop, for example, a mechanism by which a financially weak carrier's routes would be set down for reallocation in a comparative hearing open to all carriers (as is otherwise the case when the Department awards route authority), the routes would then be awarded to the various applicants on the basis of the pro-competitive public interest policies set forth in Section 102 of the Act, 'and each carrier that was awarded such a route would be required to share a percentage of the profits generated on the route over a period of time as determined in the proceeding with (a) the U.S. Government for the purpose of assuring, for example, that any liabilities, contingent or otherwise, that might be incurred by the Pension Benefit Guarantee Corporation are satisfied, (b) the financially

weak carriers' creditors if appropriate under the circumstances, and (c) finally, with the carrier itself. And, I am sure that there are a great many other ways in which such routes could be reallocated in a far more competitive way than simply approving their transfer to the highest bidder.

In the last analysis, it is critically important for the Department of Transportation and the Congress not to lose sight of the important public interest considerations in these proceedings. While it is too late to turn back the clock on the rherger policy that provided for the first wave of consolidation in the airline industry, there is time to prevent a second wave of industry consolidation. Allowing a few major carriers to monopolize international routes will make the hub concentration resulting from the mergers of the eighties seem like a minor event. The public interest demands a more equal sharing of these rights.

COMPUTER RESERVATION SYSTEMS

As noted above, it should come as no surprise that American and United, the owners of the two largest computer reservation systems in the United States, are the principal purchasers of route authority from the financially weak carriers. Indeed, American has itself purchased or proposed to purchase over $1.1 billion in airline assets in the last year. Aviation Daily (Dec. 19, 1990) at 525.

Why is this? Because American and United, through their ownership and control of these CRS systems, have access to significant amounts of cash resulting from the incredible profitability of these systems as presently regulated. Thus, based upon information provided in a study of computer reservation systems completed by the Department of Transportation in 1988 and using American as an example (although quite similar results would apply to United's operations as well), American collects fees in the range of $215 million per year from airlines whose flights are booked in its Sabre system. In addition, D.O.T. has estimated that American receives an additional $328 million per year in higher airline revenues due to the fact that travel agents book more travel on American using the American CRS than they would using a truly neutral and non-affiliated CRS (a phenomonom that is known in the industry as the "halo effect"). Moreover, since that money was obtained either directly (fees) or indirectly (halo effect) from its competitors, American has a $1 billion advantage over its competitors every year from operating a business that has nothing to do with the fares or services offered by a carrier. Finally, while these revenues are significant in and of themselves, the D.O.T. study found that 57~ of the booking fees American collects from its competitors and as much as 80% of the higher airline revenues resulting from the so- called halo effect were profits, thus indicating that American receives approximately $382 million in net cash each year by which to finance its purchases.

Under these circumstances, it is imperative that the Department and the Congress vigorously and expeditiously address the many critical issues raised by ownership of the CRS systems by American and United.

AIRPORT ACCESS

One final matter merits comment. While the issue of airport access was not specifically identified by the Subcommittee for comment, one of the most significant, if not the most significant, motivations for many of the airline acquisitions that occurred in the mid-1980s was to gain competitive control of the operating environment at the affected airports—a result which is both antithetical to the goals of airline deregulation and stands as a serious impediment to a carrier like America West being able to initiate or expand its operations as it attempts to grow.

The General Accounting Office, in a report entitled "Airline Competition - Industry Operating and Marketing Practices Limit Market Entry" (August 1990), found that airport access barriers to entry have grown in recent years in ways not anticipated when the industry was deregulated, including several physical constraints such as slots at the high density airports, control of gates and noise restrictions, and we will not reiterate those findings here. But, while the legislation recently passed by Congress has addressed certain of these concerns, these provisions have not yet been implemented and there are new, unanticipated storm clouds on the horizon arising out of the liquidation of Eastern's assets.

As the Committee may be aware, the Justice Department has expressed to the bankruptcy court its concern with respect to the proposed disposition of Eastern's airport assets at Atlanta, Washington National, LaGuardia, O'Hare and Los Angeles, which, in each instance, were purchased by the three largest carriers in the United States—American, United and Delta. It is critically important as this liquidation proceeds that the pro-competitive public interest factors that Congress has delineated in Section 102 of the Act play a role in the disposition of these assets (most particularly the F.A.A. created slots that are clearly subject to the Act) rather than the desire of Eastern's creditors to sell the assets to the highest bidder regardless of the competitive consequences. The Departments of Transportation and Justice are aware of these issues, and we implore them to act in a manner that is designed to assure a competitive U.S. airline industry.

Mr. Chairman, I am convinced that a failure by the federal government to act now will eliminate the options which currently exist to preserve competition and the many benefits of airline deregulation. A consolidation of the industry into three or four carriers will result in higher fares and service dislocations and there will be irresistible pressure to return to route and rate regulation or the surrender of some of our domestic market to foreign competition. I am equally convinced, however, that prompt action to address the short-term liquidity problem and long-term structural problems will result in a

healthy domestic airline industry and ensure that Americans continue to enjoy the benefits of airline deregulation.

We very much appreciate the opportunity to present this testimony, and I would be pleased to respond to any questions that the Subcommittee may have.

Senator FORD. Thank you.

## STATEMENT OF J. THOMAS TALBOT, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, HAWAIIAN AIRLINES, HONOLULU, HI

Mr. TALBOT. Thank you, Senator Ford. We are six time zones away from Washington, and it is indeed a privilege for us at Hawaiian Air to have the opportunity to be before you to day and to present our views.

The subjects at hand, foreign ownership and route sales, are familiar to Hawaiian because, first of all, Hawaiian is vigorously, indeed anxiously, seeking to sell some of its foreign routes. Second, Hawaiian is threatened by the revival of a foreign-owned and controlled airline, Discovery Airways. Through hard, indeed rueful, experience Hawaiian is well qualified to testify.

Let me address first the matter of route sales, an undertaking which Hawaiian would not under normal circumstances consider at all. We are not in normal circumstances. We are in the most abnormal circumstances in U.S. civil aviation since World War II. "Desperate" is not too extreme a word to use.

Several weeks ago at the National Press Club, Secretary Skinner listed some of the causes of our plight. I will not repeat them because we think he got it right, but let me point out one effect of the fact that we are now at war. Japanese tourism to Hawaii and the United States mainland has simply disappeared.

Japanese tourists have generated an enormous positive hard currency flow to the United States, and Hawaiian Airlines has been a major part of the flow, carrying tourists from Japan to Hawaii, within Hawaii and on to the West Coast for nearly 30 years. Now that business is gone. While historic interest by the Japanese in Hawaii encourages us that the traffic will return, the fact is that interruption in that vital resource for Hawaiian Airlines and the State has created serious financial difficulties.

American tourism to Hawaii from the mainland is also down in part because of the soft economy and in part because of a greatly exaggerated fear of terrorism. Altogether we have lost nearly 50 percent of our traditional business in the last 4 weeks. We are flying at half of what we would usually fly at this time of year.

Hawaiian is scrambling to survive. We are cutting back service. We are grateful to the military charter for the work we are doing in the Gulf. It is a godsend. Without it, there would be no hope for our ally.

Finally and very reluctantly—and I emphasize very reluctantly—Hawaiian is selling some of its best assets, its overseas routes. Our new scheduled service to Fukuoka, Japan will be sold to Northwest unless DOT blocks the sale. Selling this route is a bitter pill because Hawaiian painstakingly built Fukuoka-Honolulu based upon 30 years of experience in Japan, after having flown its first charters there in 1958. We flew side by side with Pan American and Northwest for 3 decades. Our roots are deep in Japan. We earned the award in October, and we genuinely hate from the bottom of our stomachs to see it go.

But we would rather sell the route than shut down the airline. This is our stark choice: Cut back where we can, scramble for new business, sell assets to raise cash, wait for the economy to expand and the war to contract.

When Hawaiian received the award to Fukuoka, we made a valiant and losing effort to get widebodied service under way. The collapsing economy and the expanding war made this impossible, and we ultimately had to agree to sell before starting service at all.

Assistant Secretary Shane recently said he did not favor the sale of international routes before service began under normal circumstances. Neither do I; neither does Hawaiian. He did not, however, say never, and so I breathed a sigh of relief. Since these are manifestly abnormal, even calamitous times, I know the Department will keep an open mind on our petition and, indeed, the petitions of other threatened carriers.

It is important that you understand that Hawaiian only agreed to sell the Fukuoka and Australia routes because of the valuable procompetitive results that would follow. They ARE.

One, the State of Hawaii will continue to receive competitive service from two carriers, ours with a 61-year-long history and a profound interest in the State;

Two, the South Pacific will continue to receive stronger, more focused and better service from Hawaiian. In fact, there are areas such as Pago Pago, American Samoa, an essential air service destination, for which there is no alternative other than Hawaiian; and

Three, Hawaii and the United States will receive new service to Western Japan, an area never served by a U.S. carrier.

Approval of the Hawaiian-Northwest transaction means that the State of Hawaii will continue to have its major industry, tourism, supplemented by the new service to Western Japan and an increased presence in Hawaii by Northwest. Northwest Airlines will continue to focus on its core business. Hawaiian will be able to focus on its core business; namely, service to the State of Hawaii.

A fringe effect: Security Pacific Bank, an institution and a representative of an industry under great pressure, will be repaid the $125 million loan, and the public will receive the benefits the DOT enumerated when it awarded the Fukuoka route to Hawaiian without the specter of another U.S. carrier under the protection of bankruptcy courts.

Approval of foreign route transfers such as the Northwest-Hawaiian transaction is a win in this case for all concerned. To sum up Hawaiian's view of the sale of international routes, from where we sit it looks like an excellent idea, perhaps a lifesaving idea.

As to the issue of foreign ownership, in regard to foreign ownership Hawaiian has some hard-won experience, simply THIS. Things are not always as they seem at first glance. Whatever criteria the executive branch adopts, we have learned it is easy to disguise total, complete foreign ownership, not to mention control, behind the facade of nominees.

Our efforts to uncover the truth about Discovery Airways were ultimately successful, but we note with dismay that the same man who put together the old Discovery is now repackaging a new Discovery. Mr. Clyde McEvoy has changed Washington lawyers and airline executives, but we believe the financing is from the same deep foreign well. We do believe, however, that foreign investment is in and of itself a laudable objective. The line to be drawn is at the point where foreign investment results in foreign control.

Our experience, therefore, tells us that DOT should take a very close look at whatever is offered for approval. Things may not be what they seem.

Thanks for the opportunity to offer our views.

[The following information was subsequently received for the record:]

HAWAIIAN AIRLINES,
*April 18, 1991.*

THE HONORABLE WENDELL H. FORD,
*Chairman, Subcommittee on Aviation, Committee on, Commerce, Science, and Transportation, U.S. Senate, Washington, DC.*

Dear Mr. Chairman:

In response to Senator Hollings' written questions, we are pleased to submit the following:

Foreign Carriers

1. Hawaiian sees no need for any mandate that foreign air carrier directors recuse themselves at Board meetings. Basic corporate and fiduciary responsibility dictate that directors with conflicts on any issue recuse themselves. Hawaiian has recusal provisions built into its by-laws. Such provisions, in Hawaiian's opinion, provide adequate protection on competitive issues. If recusal provisions are to be mandated, we would appreciate the opportunity to comment on any specific prohibition before its enactment.

Regarding plausibility, we believe that our present by-laws protect a board member from undue influence during consideration of competitively sensitive issues.

2. Hawaiian believes that foreign investment has helped its ability to serve its foreign destinations. Hawaiian does not believe its ability to serve foreign destinations would be aided by Congressional actions aimed at restating foreign carrier representation on its board.

Service to Japan

Hawaiian Airlines has served Japan as a charter carrier since the middle 'SOs. The service is between Honolulu to several points in Japan—principally Nagoya, Fukuoka, Sapporo, Ubihiro and Akita.

All trips originate in Japan and most passengers are Japanese citizens visiting the U.S. Most charters are arranged several weeks in advance and are almost entirely tourists. The benefit is overwhelming to the American, rather than to the Japanese, balance of payments.

In recent years, Hawaiian has flown 60-70 charters (30-35 round trips) per year. Hawaiian has had sales offices in Tokyo and Osaka for 30 years.

Sincerely yours,

THOMAS TALBOT,
*Chairman of the Board and Chief Executive Officer.*

Senator FORD. Thank you. Mr. Checchi.

## STATEMENT OF ALFRED A. CHECCHI, CHAIRMAN, NORTHWEST AIRLINES

Mr. CHECCHI. Good morning, Mr. Chairman and Senator McCain.

While the airline industry has been a proud participant in our war effort, I would also submit that it has been the principal industrial war casualty. The war began on August 2 with the Iraqi invasion of Kuwait. The immediate effect on our industry was a near doubling in the price of jet fuel. To put this into perspective, an industry that had never earned more than $1.75 billion in a year had its fuel costs increased by an annualized $8 billion. The results for the fourth quarter of 1990, the first full post-invasion quarter, were a nearly $2 billion industry quarterly loss.

On January 16, the direct military involvement of U.S. military personnel commenced, and the actual hot war for the airline industry began. Owing to the perceived threat of international terrorism, U.S. domestic traffic has declined an estimated 10 to 15 percent, and international travel has plummeted by as much as 50 percent in some markets.

The economic effect of this on the airline industry is devastating. Losses for the first quarter of 1991 will probably exceed the $2 billion loss for the preceding 3 months, meaning the industry will have lost nearly $4 billion during the Persian Gulf War. This is nearly 50 percent of its total net worth.

Now the overall effect of these losses has been a wholesale, well documented destruction of the U.S. transportation system. Names like Eastern Airlines, Pan American Airlines, Continental Airlines, TWA and Midway have either liquidated, declared Chapter 11 or defaulted on their debts. U.S. Air has cut 20 percent of its work force during the last 3 months and announced that it is "fighting for survival". Even the three major carriers—American, United, and Delta—are cutting back operations and could not operate indefinitely under these circumstances.

We at Northwest have lost much of the financial reserves we had earmarked for expansion and service improvements that we consider vital to our long-term competitive position.

Now in spite of recent encouraging news from the Middle East, no one really knows when this war is going to end or what the peace is going to look like or how long it will take for economic activity and travel practices to resume more normal patterns. Certainly the summer season will be adversely affected based on current cancellations.

Now many of the government's actions have exacerbated the problems created by the war. As purported security measures, the U.S. Government has issued broad warnings against flying abroad which have added to the unwarranted public hysteria over fear of terrorism.

The U.S. Postal Service has decided that despite the highest level of industry security, it is going to divert certain packages from being transported by U.S. carriers.

The INS has indicated that it is considering abandoning the transit without visa program, which would cost our industry $150 million annually.

In addition to the above, over the past year, the Government has passed legislation that is adverse to long-term industry capital formation. The domestic ticket tax has been raised from 8 percent to 10 percent, an estimated cost of $800 million per year.

Local airports have been granted the right to impose passenger facility charges, an estimated cost of $1.2 billion per year, and Stage 2 aircraft, which comprise the bulk of commercial airline fleets outside of those operated by the big three, must be reduced to 15 percent by the end of 1999 and eliminated by the end of 2003. Many carriers have no prospect of attracting the capital to do this.

The cumulative effects of the war, the collapse of capital markets and airline asset values and various Government policies is that the U.S. airline industry has been devastated. It is in light of all this that I would like to comment on DOT's recent decision to reinterpret foreign ownership restrictions and expedite the review of international route sales. We support both proposals.

To the extent a carrier is able to raise cash by selling an international route, it provides that carrier some additional cash to attempt to find a formula to survive in a very turbulent period. In addition, as domestic route patterns change, international route sales allow the market to allocate routes to the carriers who can use them most efficiently.

Existing legislation adequately protects the public interest by providing for the Departments of Transportation and Justice to approve each of these transactions. Attempts to seek foreign investment are an outgrowth of the industry's capital shortage resulting from historically low profitability. Over the past decade the industry has averaged a 6.5 percent annual return which is well below the 12 percent that the Civil Aeronautics Board previously determined was necessary for the industry to remain financially healthy. Small wonder that the industry is capital short and seeking every available source.

KLM's investment in Northwest, for example, has been a most important source of capital for our company. Completely consistent with U.S. citizenship and control requirements, it has not resulted in any element of control by KLM of Northwest, nor has it hampered in any manner our ability to meet our obligations under the Federal CRAF Program.

However, foreign carriers are also facing financial difficulties and are not currently seeking to invest in U.S. carriers. Quite frankly, even unrestricted foreign investment in U.S. carriers would do little to solve this industry's short-term capital problem.

Although it is likely that the U.S. airline industry would have faced increased consolidation over the next decade, it is anticipated this process would have

proceeded anyway on a relatively steady basis without serious service disruption. The immediate results of the economic dislocation by the Gulf conflict have been devastating cash flow losses and a collapse of orderly markets.

For those who profess belief in the market as the best determinant of asset allocation, I submit this may be true, but at the present time orderly capital markets simply do not exist for this industry. At times like this, as in the case of the 1987 stock market crash, it is not uncommon for the Federal Government to inject liquidity so that market mechanisms may resume their normal function. Even though foreign airlines are suffering, many are Government owned or controlled, and their governments will ensure that they will survive this downturn either by modifying government policies or by providing direct subsidies.

In closing, I suggest that our Government consider the destruction that has been wrought by Saddam Hussein on the U.S. aviation infrastructure. I believe that a plan for the U.S. airline industry to preserve our Nation's air transportation infrastructure should be given serious consideration.

Thank you.

[The statement and questions and answers follow:]

STATEMENT OF NORTHWEST AIRLINES

Good morning, Mr. Chairman and Members of the Committee. am Al Checchi, Co-Chairman of Northwest Airlines. I appreciate the opportunity to testify here today.

PARTICIPATION IN CRAF

First, I would like to comment on the role the airline industry is playing in Operation Desert Storm. As part of the Civilian Reserve Air Fleet (CRAF) program, U.S. airlines have carried over 60% of all troops and over 20% of all cargo to the Middle East. Northwest, and I am sure I speak for the entire airline industry, is pleased and proud to be a part of this effort.

EFFECT OF WAR

While the airline industry has been a proud participant in our war effort, it has also been the principal industrial war casualty.

The war began on August 2 with the Iraq invasion of Kuwait. The immediate effect on the airline industry was a near doubling in the price of jet fuel, a significant cost to airline operations. To put this into perspective, an industry that had never earned more than $1.75 billion in a year had it's fuel cost increased by an annualized $8 billion. The results for the 4th quarter of 1990, the first full post-invasion quarter, were a nearly $2.0 billion industry loss.

On January 16, the direct military involvement of U.S. military personnel commenced and the actual "hot war" for the airline industry began. Owing to the perceived threat of international terrorism, U.S. domestic traffic has declined an estimated 10-15%, and international travel has plummeted by as much as 50% in some markets. The economic effect of this on the airline industry is devastating. Losses for the first quarter of 1991 will probably exceed the $2.0 billion loss for the preceding three months, meaning the industry will have lost over $4 billion during the Persian Gulf War. This means the airline industry will have lost nearly 50% of its total net worth in just six months.

The overall effect of these losses has been wholesale destruction of the U.S. air transportation system.

Eastern Airlines has moved from Chapter 11 bankruptcy to liquidation.

Pan American Airlines has announced the sale of its vital London routes and declared Chapter 11 bankruptcy.

Continental Airlines has declared Chapter 11 bankruptcy.

TWA has defaulted on its debts and is in the process of trying to sell many of its operations.

Midway Airlines has sold its Philadelphia hub and has defaulted on its debts.

USAir has cut 20 percent of its work force and announced that it is "fighting for survival."

America West is in the process of retrenchment, the magnitude of which is yet to be determined.

Even the three major carriers, American, United, and Delta are cutting back operations and could not operate indefinitely under these conditions.

We at Northwest have lost much of the financial reserves we had earmarked for expansion and service improvements that we considered vital to our long term competitive position. Like other carriers, we are husbanding our remaining resources to meet an uncertain future. In spite of recently encouraging news from the Middle East, no one knows when this war will really end or what the peace will be like or how long it will take for economic activity and travel practices to resume more normal patterns.

Certainly the summer season will be adversely affected based on cancellations to date.

RECENT GOVERNMENT ACTIONS

Many of the government's actions have exacerbated the problems created by the war:

As purported security measures:

The U.S. government has issued broad warnings against flying abroad which have added to the unwarranted public hysteria over fear of terrorism and contributed to unprecedented declines in travel volume. Notwithstanding this, Mrs. Bush's recent commercial flight and demonstration of confidence in the air transportation system is greatly appreciated.

The U.S. Postal Service has decided, despite the highest level of industry security, to divert certain packages from being transported by U.S. carriers. This will cost the industry an estimated $100 million per year.

The INS has indicated that it is considering abandoning the "transit without visa" program. This allows passengers who have already gone through security check points for international flights to change planes without going through customs. If it were executed, this would cost the industry an additional $150 million per year.

In addition to the above, the Government has passed legislation over the past year that is adverse to long term industry capital formation and profitability.

The domestic passenger ticket tax has been raised from 8% to 10% — an estimated increased annual cost of over $800m.

Local airports have been granted the right to impose Passenger Facility Charges at an estimated annual cost of $1.2 billion.

Stage 2 aircraft which comprise the bulk of commercial airline fleets outside of those operated by the three largest carriers must be reduced to 15% by the end of 1999 and eliminated by the end of 2003. Many carriers have no prospect of attracting the capital to do this.

The cumulative effects of the war, the collapse of capital markets and airline asset values, and various government policies is that the U.S. airline industry has been devastated. Nearly 50% of industry capacity could be in bankruptcy by mid-summer with large amounts of this capacity permanently grounded. As this committee well knows, when a U.S. carrier goes out of business, workers lose jobs (over 25,000 in the past 3 months alone), competition is diminished, and communities lose vital service.

FOREIGN INVESTMENT AND INTERNATIONAL SALES

It is in light of all of this we should like to comment on DOT's recent decision to reinterpret the foreign ownership requirements, and to expedite the review of international route sales.

We support both proposals. To the extent a carrier is able to raise cash by selling an international route, it provides that carrier additional time to attempt to find a formula to survive this turbulent period. In addition, as domestic route patterns change, international route sales allow the market to allocate routes to the carriers that can use them most efficiently. Existing legislation adequately protects the public interest by providing for Department of Transportation and Department of Justice approval of these transactions.

Attempts to seek foreign investment are an outgrowth of the industry's capital shortage resulting from historically low profitability and exacerbated by the current crisis. Over the past decade the industry has averaged a 6.5% rate of return, well below the 12% return the Civil Aeronautics Board previously determined was needed for the industry to remain financially healthy, and even below the yield of a risk free treasury security over the same period. Small wonder that the industry is capital short and seeking every available source. KIM's investment in Northwest, for example, has been a most important source of capital for our Company. Completely consistent with the U.S. citizenship and control requirements, it has not resulted in any element of control by KIM of Northwest nor has it hampered, in any manner, our ability to meet our obligations under the CRAF program.

However, foreign carriers are also facing financial difficulties and are not currently seeking to invest in U.S. carriers. During this month alone, British Air announced plans to lay off 4,300 employees and send another 2,000 home at half pay; SAS announced plans to eliminate 3,500 jobs by the end of 1992; and KIM recorded a December quarter 1990 loss of $129 million. Quite frankly, even unrestricted foreign investment in U.S. carriers would do little to solve the industry's capital problems.

NEED OF SUPPORT FOR AVIATION INFRASTRUCTURE

Although it is likely that the U.S. airline industry would have faced increased consolidation over the next decade, it is anticipated that this process would have proceeded on a relatively staged and orderly basis without serious service disruption or overall economic damage. The immediate result of the economic dislocation created by the Gulf conflict has been devastating cash flow losses, and collapse of orderly markets for capital and asset values including aircraft routes, gates, and slots. For those who profess belief in the market as the best determinant of asset allocation, I submit that this may be true, but at the present time, orderly capital markets do not exist. At times like this as in the case of the 1987 stock market crash it is not uncommon for the Federal Government to provide liquidity so that market mechanisms may resume their normal functions.

Even though foreign airlines are suffering, many are government owned or control led and their governments will ensure that they will survive this downturn either by modifying government policies

or by providing direct subsidies. The U.S. government should exhibit a similar level of commitment to our industry's future.

In closing, I suggest that our government consider the destruction that has been wrought by Saddam Hussein on the U.S. aviation infrastructure. I believe that a plan for the U.S. airline industry to preserve our nation's air transportation infrastructure should be given serious consideration. Thank you very much. I would be pleased to answer any questions.

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NORTHWEST AIRLINES,
*March 13, 1991.*

HON. WENDELL H. FORD,
*Chairman Subcommittee on Aviation, Committee on Commerce, Science and Transportation, U.S.Senate Washington, D.C.*
HON. JOHN MCCAIN,
*Ranking Republican Member, Subcommittee on Aviation, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, D.C.*

Dear Senators Ford and McCain:

I appreciated the opportunity to testify before the Aviation Subcommittee last month. During that hearing, you referred to an Aviation Daily article published the day of the hearing which stated that KLM owns 49% of Northwest. As I testified at the hearing, the article is inaccurate. I can understand that the Senators on the Subcommittee were reacting to that article, and I appreciate this opportunity to clarify further the issue.

In brief, KLM owns 20% of Northwest common stock and owns only 10.5% of the voting stock. By contrast, my partners and I own 45% of the company's common stock, and own 61% of the voting stock.

The attached chart [1] sets forth in detail the interest of each shareholder of Northwest. As noted in the chart:

Consistent with the statutory provisions in the Federal Aviation Act, non-US. citizens own less than 25% of the voting stock (KLM owns 10.54% and Elders owns 14.45%). Most importantly, the Checchi Group (which consists wholly of U.S. citizens) owns 61% of the voting stock and controls the company.

KLM owns 20% of the company's common stock, about half of which is non-voting.[2] Consistent with its ownership interest, KLM has the right to designate three members out of 15 (20%) of the Wings Board of Directors. (Wings is the parent company of Northwest.)

KLM also owns preferred stock in Northwest. The preferred stock is a passive investment: the holders have no ownership rights, no right to future profits, no right to vote (except to prevent dilution of their interests), no right to nominate directors, and no restrictive covenants. Like subordinated debt, and unlike equity, the preferred stock holders are merely guaranteed the payment of interest and repayment of principal at the conclusion of a fixed term. Since the preferred stock is technically considered "equity", DOT considers the total "equity" of Northwest to include both common stock and preferred stock. However, this interest is equity only as a matter of semantics. From a corporate control standpoint, it is debt. Any concern about the level of the total equity investment in Northwest is unfounded, because Northwest's preferred stock has no control attributes. The only proper gauge of ownership in Northwest is the ownership of common stock.

Finally, I would like to express my agreement with Secretary Skinner concerning the importance of using U.S. policy to foster worldwide liberal aviation regimes. U.S. carriers welcome the opportunity to compete in a truly open competitive environment. As noted during the hearings, the Netherlands has had a liberal bilateral aviation policy with the U.S. The KLM investment in Northwest is an excellent example of rewarding such policies.

Thank you again for the opportunity to testify. I would appreciate your making this letter a part of the hearing record.

Sincerely,

ALFRED A. CHECCHI, *Chairman.*

NORTHWEST AIRLINES,
*March 13, 1991.*

HON. WENDELL H. FORD,
*Chairman Subcommittee on Aviation, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, D.C.*

Dear Mr. Chairman:

As you requested, please find below responses to the Committee's questions following the February 19th hearing on foreign ownership and international route sales.

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[1] The chart was not reproducible.

[2] KLM can convert its non-voting common stock to voting common stock at any time. However, the statutory provision on foreign ownership of voting stock currently limits KLM's voting ownership to 10.45 percent.

FOREIGN CARRIERS

*Question:* Is there a need to mandate that foreign carrier directors on the boards of U.S. carriers recuse themselves from specific types of information? Is this a plausible means to guard against potential competitive problems?

ANSWER: I believe that it would be useful to require that foreign carrier directors on boards of U.S. carriers be recused on issues relating to U.S. bilateral negotiations with the home-country of the foreign director.

However, I believe this is the only circumstance which requires the recusal of a foreign director. Foreign directors need not be recused with respect to so-called "competition issues." Since an investment by a foreign carrier in a U.S. carrier is reviewed by the Department of Justice, any potential impact on competition would have already been cleared by that Department prior to any Board of Directors' meeting attended by foreign citizen directors.

In Northwest's Consent Order 89-9-51 with the DOT—an order with which we have strictly complied—we agreed to have foreign directors recused from any actual or potential "competition" issues; however, we do not believe such a recusal is necessary given the DOJ antitrust clearance.

*Question:* Once a foreign carrier invests in a U.S. carrier, many claim that the host country's incentives to negotiate a more liberal bilateral agreement will change. All of you will be affected if this claim is true. How do you anticipate these changes will affect your carrier's ability to serve that country and what steps should Congress be looking at to address this potential problem?

ANSWER: Any policy which results in a foreign country having less interest in negotiating a liberalized bilateral with the U.S. will likely work to the disadvantage of U.S. carriers. U.S. carriers—and the U.S. and global traveler—benefit when new bilaterals create additional international routes.

However, if a country already has a completely liberal bilateral with the U.S., there obviously would not be any effect on the bilateral agreement if a carrier from that country invested in a U.S. carrier. This is the case with the Netherlands and the KLM investment in Northwest. Since 1977, the Netherlands has had a liberal bilateral aviation policy with the U.S. and the KLM investment has not affected that policy.

We believe that Congress should provide the Department of Transportation the flexibility to consider foreign investment issues on a case-by-case basis to allow the Department to take into account the liberality of the aviation regime of the country of the foreign investor.

REVIEW PROCESS

*Question:* It took DOT more than a year to enable your airline to be permitted an equity investment of more than 25% by a foreign entity. Yet, the final part of the process, from the filing of your request to final DOT approval, took less than two weeks, leaving many parties less than satisfied. Having been through the long and short of it, and recognizing that your foreign ownership request has been granted, can you suggest procedures that could be employed in the future so that all elements can be addressed? Specifically, how can Congress address the needs for an expedited review, ensure that all interested parties have an opportunity to participate, and still ensure a timely decision?

ANSWER: I appreciate the opportunity to clarify a misconception about the DOT approval of KLM's investment in Northwest. During the 18 months following the Northwest Consent Order, 89-9-51, Northwest had a constant dialogue with the Department of Transportation. Pursuant to DOT requests, we filed a substantial amount of data, much of which was on the public record and available for public inspection. Interested parties had ample time and ample opportunity during that period to develop and express their views to the Department.

After DOT issued the original consent order, any party concerned about the KLM's investment and the requirement that a portion of that investment be placed in a voting trust could have petitioned DOT to reconsider the decision.

After the consent order, Northwest twice publicly requested (a request which was widely reported) and received postponements from the requirement that KLM divest a portion its investment. Any interested party could have urged DOT to reconsider its position on this matter.

In September 1990, DOT approved an investment by Scandinavian Airlines System (SAS) in Texas Air Corporation (now called Continental Holdings Airlines, Inc.) adopting the same basic principles applied by the Department in its January 1991 decision on KLM's investment in Northwest. Again, in that case, interested parties had an opportunity to consider DOT's approach, comment on that particular matter, and develop positions on the issue of foreign investment in U.S. carriers.

In short, contrary to the claim of some parties, DOT had been developing its position on the issue of foreign investment in U.S. carriers over an extended period of time, during which interested parties had an opportunity to develop their own positions and express their views to the Department. Although the entire process extended over a long period of time, we trust that given the experience that the DOT developed in our case, the process will be completed more promptly in the future.

HAWAII-FUKUOKA, JAPAN

*Question:* Mr. Talbot indicated that Assistant Secretary Shane has stated that the sale of route awards, where the route has never been served, should be prohibited. Please explain why you believe the circumstances in the Hawaii-Fukuoka, Japan case are different.

ANSWER: First, I should clarify that Assistant Secretary Shane has stated that generally a route sale should be prohibited if the route has never been served. The basis for the general rule is a valid public policy concern that carriers not be allowed to "traffic in certificates"; however, that concern has no basis in fact here.

HAL pioneered charter service between Honolulu and Fukuoka, and has a ma;or investment of "sweat capital" in this route. Moreover, it has pursued scheduled service to Japan for over four decades. There is no basis to suggest that Hawaiian pursued this route merely to sell it.

The general rule implies that under certain circumstances, exceptions should be considered. The extraordinary circumstances in the Hawaii Fukuoka case is a prime example of when such an exception is warranted.

In any event, the parties have restructured the transaction to permit Hawaiian to operate the route with aircraft wet-leased from Northwest. Thus, the transaction no longer presents the DOT with the need to resolve this issue.

Once again, Mr. Chairman, I appreciated the opportunity to testify and look forward to continuing to work with you on the important issues facing the aviation industry.

Sincerely,

ALFRED A. CHECCHI, *Chairman.*

Senator FORD. Thank you, Mr. Checchi.

Mr. Talbot, I will work my way down. You stated you hope to sell one of your routes before you start service on it. Of course, this would be an unusual decision if it is approved.

Other carriers have objected. I don't know how strenuously, but it does set a precedent.

Why is this sale a good idea?

Mr. TALBOT. Senator, over the last 40 years, we have been building an equity in Japan. Since the end of World War II, we have been a participant in every route application proceeding to Japan.

During that time period, we have built up the largest charter business to Japan in the industry. We have opened new markets. We have paved the way to places like Nagoya and Fukuoka in Japan, which are now mainstays or will soon be mainstays in the U.S. transportation system.

We feel that all those things, together with the dozen or more people that we have stationed in Japan, our offices in Osaka and Tokyo, all those things that we've done in preparation to serve the route represent equity.

These are not ordinary times. They are extraordinary times. Under any other circumstances, we would never consider the sale of this route. But we do have an equity in it. We have the equity of all that try, all those years of trying, all those dollars, all the service that we have opened up there.

For those reasons, I think we have more than just a route right that was recently granted and, therefore, we have the right to sell it.

Senator FORD. All of you are giving credit to Saddam Hussein for creating the problems that you have. But yet, you said that the Persian Gulf has been your survival.

Now, it's awfully hard to look at both sides of that. What is the effect of the Persian Gulf as it relates to your airline?

Mr. TALBOT. We fly DC-8's to the South Pacific and have always flown them for the Military Airlift Command, an older kind of aircraft. In addition to that, we rented additional L-1011's for last summer's season. Those aircraft have been pulled out of their regularly scheduled services to the West Coast with the drop-off in traffic and redeployed to the Middle East and to points really in the Pacific as well for the military.

So, instead of suffering the fuel price increase, we are protected by Military Airlift Command for anything over a base price.

Secondly, we are guaranteed full airplanes by the Military Airlift Command.

So we reacted. We are a small air carrier. We were fortunate enough to be able to react very quickly, to pull airplanes out of regularly scheduled service when the demand vanished and to place them into military service.

Senator FORD. So the government is guaranteeing you a full airplane. You are not being hurt financially, then, by the increase in fuel costs?

Mr. TALBOT. Well, insofar as the airplanes in the Gulf are concerned, we are not. But we are hurt very, very badly.

We serve far-flung points in the South Pacific, like Raritonga and Samoa and so on, and we are subject to enormous price increases in those places where there is only one supplier.

Senator FORD. But that is being offset some by your ability to fly for the Federal Government.

When you say that your tourism has dropped some 50 percent, does that mean to the whole Hawaiian area that tourism has dropped 50 percent? Or is it just your carrier that has dropped 50 percent?

There are other airlines that fly into Hawaii, other than yours. I wonder if the Japanese airlines are carrying the Japanese, rather than using your airline.

Mr. TALBOT. We have several different kinds of service. Our principal business is carrying people among the Hawaiian Islands.

The Japanese represent about 30 percent of the travelers to Hawaii. But they represent about half of the dollars spent. There is a higher propensity for them to travel among the islands and see more islands. So that we, actually, year to year, have about half as many passengers flying among the islands.

The stop in Japanese tourism was like turning off a faucet.

If you would like to go into it a little bit, I think it was the Speaker of the Diet in Japan who got on the television and told the Japanese people that it would be shameful for them to come to the United States when American boys were dying for them in the Middle East. He used the Hawaii example specifically.

So it is just like somebody turned off the spigot from Japan.

There is another aspect, which is the trans-Pacific, and it is off about 20 to 30 percent.

Senator FORD. Hawaiian Airlines has had, I believe, somewhere between 15 percent to 20 percent stock ownership by Japan Airlines, and has for years, I guess. What has been your experience with that?

Mr. TALBOT. Japan Airlines has never attempted to exercise control over Hawaiian, first of all, not a scintilla. Secondly, they have been most helpful to us in marketing our products and services in mainland Japan. So I can say that our experience with Japan Airlines has been that they are a passive investor and they have helped us.

Senator FORD. What if they owned 49 percent of your airline? Would it be any different?

Mr. TALBOT. The Japanese people are not easy to discern. Their motives and long-term objectives are well thought out. They do not communicate them well to us.

But based upon what I've seen to date, as I have said, there has been no attempt to exercise control. And if they stayed within the Secretary's current guidelines, I think we would have no objection to an increase in their ownership in the company.

Senator FORD. What if they required as a part of their infusion of money that you increase your Board of Directors so that they might have three or four members on that. How would that affect you?

Mr. TALBOT. Our Board, Senator, is 15 strong. Once again, we would have no objection to having them. Their perspective is valuable. The people that they

send to us are good people with a depth of sound experience, and they offer some good insight into matters which are helpful to us.

I might also say that when our transaction with Northwest is completed, we will have two members, two nominees, from the Northwest ownership on our Board, and we are looking forward to that.

Senator FORD. They won't be foreigners, though, will they? They will be U.S. citizens?

Mr. TALBOT. I think you are correct, sir.

Senator FORD. Thank you very much. That is the point I wanted to make.

Mr. Callison, it appears from your statement—and I hope I have it right—that Delta kind of wants it both ways, to buy routes for itself and to obtain routes from the Department of Transportation.

Why should the Department give you some of the TWA- London routes when you were not willing to take a risk and buy TWA's authority?

Mr. CALLISON. Mr. Chairman, I think the premise of that question might be that we are playing the role of a spoiler or that we want to get something for free. I want to explain to you that that is not the case.

Senator FORD. Oh, I wouldn't accuse you of wanting anything for free, Mr. Callison.

Mr. CALLISON. Well, if the DOT just gave us the route, I guess that might be considered free.

Senator FORD. All the routes have been given and all the slots have been given from the beginning.

Mr. CALLISON. That's true. I appreciate that.

But I want to assure you that we are not just taking an obstructionistic position.

Delta is today a significant competitor in the U.S.-U.K. market. We operate out of Atlanta. We operate out of Cincinnati. We are a strong competitor over our present U.K. routes, and we have an interest in remaining a strong competitor in those markets.

As a consequence, we have a lot of interest in what the policy objectives of the DOT are. We want to be sure that in route transfer cases, just as in initial route cases, the Department applies strong pro-competitive positions. That is the gravamen of what we are saying.

We are saying that they have to stick with those pro-competitive positions.

Now, if you take some route transfers that are not very controversial, they can probably be handled without the hearing process. But this one is not a routine type of transfer.

If you take United-Pan American, and American-TWA together, those two proposed transfers, that is a massive realignment of the route system across the Atlantic, at least and especially to and from the U.K., which is the largest European market and the largest European gateway.

As I said in my testimony, those two carriers combined would wind up controlling 80 percent or more of the traffic to and from the U.K. That is going to have a severe impact on the others of us who already operate to and from the U.K. That is why we want to be sure that the Department applies its pro-competitive policies consistently.

Now, in a case of that size, that massive a situation, we think you have to have an oral evidentiary hearing to ferret out all of the facts and all of the considerations, even if it does take a little longer than the processing that was done in the United-Pan American case.

When you do that, when you get all the facts out and all the problems, it is entirely possible that DOT is going to say there, as they did in the United-Pan American Pacific transfer case, that certain routes have to be spun off and be

considered for other carriers instead, in order to keep the overall public interest in competitive service viable and active.

So that is our overall position, to be sure that they apply that policy consistently.

On the other hand, if they are not going to do that, if they are not ever going to have a hearing with respect to any proposed route transfer, then we would like to know that, too, so that we can judge our own actions accordingly in the future. But our goal is to be sure they do a pro-competitive job.

Senator FORD. Do you think the Secretary should have a rule making?

Mr. CALLISON. With respect to foreign investments?

Senator FORD. Yes, sir—foreign investments, the whole gamut.

Mr. CALLISON. That might be helpful.

I think it can be handled on a case by case basis. But what he has done in the KLM case so far is sort of announce it as if it was a policy change. That normally is done through a rule making and not on a case by case basis.

But our concern is the impact on the bilateral aviation agreement process, and a rule making would allow us to bring those arguments out much more fully. Yes, that's true.

Senator FORD. Thank you very much.

Mr. Checchi, I want to compliment you. Sometimes it takes me better than a month to get an answer back from the Department of Transportation, and you got a ruling in three days.

It tells me that you have more influence with Mr. Skinner than some of us here on the Hill do.

Mr. Checchi, your testimony indicates that the Gulf War and the laws—and I underscore the laws—passed by Congress are the major causes of your airline's problems. And, of course, we are the whipping boy, and I understand that.

However, you failed to mention debt, which is the common characteristic, I think, of all the troubled airlines you listed in your statement. You ticked them off there.

It seems to me that you take a risk when you leverage a carrier. I think that is a judgment that is made. When it fails, you ask the government to help. You are asking us now to take the ticket tax and put it back into the airlines, and that is about like trying to bail out everything else.

Why should the government interfere now? You didn't ask them when you leveraged the buy-out. Why should we be involved now?

Mr. CHECCHI. First of all, Senator, let me make it clear that Northwest Airlines is not in danger of failing or declaring Chapter XI. There will be at least four surviving carriers in the United States, and Northwest will be one of them.

We do not have a problem with our debt. We do not have a problem making our debt service payments or any payments of the company. In fact, we have very substantial cash reserves.

I am here to discuss what I think is a very serious short-term liquidity problem that the industry has. I believe that, while it is true that that problem is mightily exacerbated by the capitalization structure of many of these airlines, clearly, the events of the past six months have been extraordinary in their cash flow implications for this industry.

There is an invasion and immediately the price of fuel doubles. The industry loses $2 billion the next quarter.

There is the start of hostilities, and immediately international travel falls by 50 percent and domestic travel falls by 10 percent to 15 percent. And you have a liquidity implosion on this industry.

All that I have suggested is that perhaps one should look at the industry and say should we try to liquify it in the short run so that a combination of market forces and/or government policies can unfold over the subsequent couple of years in order to produce a desired, long-term industry structure.

Our company is not asking for a "bail-out." But it is clear from everything one reads in the newspapers and I think the tenor of these discussions, that this industry, in the short-run, has a very, very serious problem getting access to capital. I think it is clear that if market forces are left to determine the shape of this industry, given a liquidity crunch, you may end up with an industry structure that is not particularly palatable to the long-term public interest.

But we are not asking for a bail-out, and Northwest Airlines is clearly not in trouble.

Senator FORD. Both Northwest and KLM fly routes from the U.S. to Europe and are competitors in some markets, as I understand it. Secretary Skinner has identified this as a concern when he reviewed the Northwest acquisition in 1989.

Has this had any effect on your competition or any effect on your ability to survive, or to increase your income?

Mr. CHECCHI. At this stage, the effect of our relationship with KLM Airlines has been revenue and profit neutral. We have had control of the airline for approximately a year and a half. We are only beginning to explore possible ways that we could work together, possible ways that we could help one another. But at this stage, we have made no concrete changes whatsoever to affect the operations of our airline.

Senator FORD. You mentioned and I think two other witnesses have also mentioned the public's concern and the public's right with respect to the problems that you are facing. How should these public rights be safeguarded as it relates to the so-called globalization of the airline industry?

Mr. CHECCHI. It is a very difficult question when you have bilateral agreements between governments, where each agreement is different. Ideally, in the long-run, one should be able, I believe, to get on an air flight and fly that airline virtually anywhere in the world.

I believe that the public would be very well served in that kind of arrangement. But, given where we are now and the distance from here to that ideal, frankly, Senator, I don't know what we should do at this point to try to achieve that ideal.

I might comment very, very briefly, however, on this issue of permitting investment by foreign carriers in U.S. carriers.

It is unfortunate that the case of Northwest Airlines has been used as one to perhaps extend and make a public policy statement.

In the case of Northwest, KLM does not own 49 percent of Northwest Airlines. KLM owns 20 percent of Northwest Airlines. They have a 20 percent interest in the common stock, and they have something less than a 20 percent interest in the voting.

You also have the fact that two people, me and a partner, own 45 percent of the company and have 60 percent of the voting stock. That is a very important set of circumstances.

KLM invested in an issue of preferred stock that confers no voting rights, no ownership rights. It is merely a passive financial instrument that a dozen years from now will be paid off. It is unfortunate that the implication has been left that somehow KLM owns 49 percent of our company. They own a 20 percent interest in its future profits. They have a less than 20 percent vote. And you have the very important fact that two people, together, have 60 percent of the votes.

It would be a very different circumstance if any individual, foreign or domestic, owned 10 percent or 15 percent of this company and the largest second shareholder owned 1 percent.

Senator FORD. Well, Mr. Checchi, you had better get that information out because everything that the Secretary talks about is such that this is the first time it has ever been refuted. "Aviation Daily" comes out with 49 percent. So, somewhere along the way, you are going to have to get to your own, in-house people, and begin to refute the 49 percent ownership. This is because the 25 percent was reduced from over 50 percent by Secretary Skinner visiting with you, and you had to struggle and to make different arrangements. Then when your payment was due, instead of having 25 percent, you increased the purchase from 25 percent to 49 percent. That then gave you the money to make the purchase of Eastern at National. When your bid was somewhat less than United's, and it was not accepted by the bankruptcy judge, you raised yours up to equal United's.

Now, if that statement is incorrect, then I think you have a PR job as it relates to what you have and what you do not have. You did expand your Board, did you not, from 12 to 15?

Mr. CHECCHI. We did, Senator.

Senator FORD. And three KLM selections went on your Board.

Mr. CHECCHI. Yes, sir. There are three members of the Board, out of 15, which is 20 percent, which is consistent with the amount of common stock that they own.

Senator FORD. I have no problems with what you are doing, and with your statement. But, somehow or other, there is the perception out there and this is the first time it has ever been refuted.

Mr. CHECCHI. That's correct. We have a perception problem.

Senator FORD. I have not seen anything in the newspapers, in the "Wall Street Journal," the "New York Times," or "Aviation Daily" about this, or even this one (indicating). I have them all over the place.

So I think your people had better start working on some slick advertising as it relates to other things and get your financial house in order perception-wise, because right now, KLM, in my mind, until you made your statement, owned 49 percent.

Mr. CHECCHI. Yes, sir. I understand that.

Senator FORD. And you indicated your Board to make three slots for them. Then, when you got a three day turn-around from the Secretary of Transportation, it was a large miracle, a large miracle. So you have done a good job.

We are keeping you all here too long and I am holding up Senator McCain.

Mr. Beauvais, you made some interesting suggestions about reallocation of international routes in ways that would be fair to the smaller or newer carriers, I believe.

How would you assess these carriers' ability to compete with the major carriers, with the strong, established foreign airlines on these international routes?

Mr. BEAUVAIS. That is a very important point.

Senator FORD. I thought so.

Mr. BEAUVAIS. Number one, I would like to add one thing to Mr. Checchi's comments. There will be five airlines that survive. America West will be the fifth.

Senator FORD. You know, we look back at 1978, too, and we look at what was said there. Well, we will look five years forward to today and see how you have turned out, Ed, you and Mr. Checchi and the rest of you.

Mr. BEAUVAIS. Okay. That's a promise.

The U.S. airline industry carriers 500 million passengers a year. Worldwide, the total is 900 million. So, five out of nine are U.S. domestic.

We have grown up in the last 12 years in a deregulated environment where we know how to compete as carriers.

The tenacity of the competition in the U.S. domestic market is far more significant than it is in the international market. We live for the day that we can compete with foreign flag carriers on international routes that have been granted through the normal process that we understood has been the case for years and years.

I think if you go back in history, you will find that some of the smaller U.S. carriers serve the international routes far more aggressively when they have an opportunity because it is more important to them. National Airlines in the Miami-London route for years was a phenomenal success on that route. No other airline has seemed to be able to make it work since National was sold to Pan Am.

America West finally gets into Japan. I think you should watch this airline serve that route in competition with both JAL and ANA. These routes are very important to us. We don't win that route unless the Department of Transportation reviews the evidence and determines that we are fit, willing, and able to provide that service.

We know how to compete because we were born in deregulation. We know how to establish ourselves and go for the market that will be successful for us. And in our opinion, the subject of today's hearing, foreign ownership and international route sales, really is probably played out of proportion in terms of the solutions to our industry's problems today.

As Mr. Checchi described, and I totally agree, it is an issue of liquidity, short-term, created by the war in the Persian Gulf, and there are solutions to that, short of quick approval of international route sales that seem to be the only salvation for certain airlines.

In our opinion, there are much better approaches that can be taken to the problem.

But, as far as we can see, the U.S. carriers have nothing to fear when they face international expansion opportunities. The route system inherent in the U.S. domestic market is very strong, and it will support U.S. carriers launching major international route development throughout the world, after careful review by the United States Department of Transportation and selection by that body.

In our opinion, that system works, and in our opinion, that system moves on the principles that the basic foundation of the commercial aviation industry in the United States is best served by America West flying from Honolulu to Nagoya, by Delta Airlines flying from Portland to Nagoya, by other carriers getting those routes after full evidence has been granted.

We are not talking about a lot of issues here in terms of many foreign routes, and we are not talking about a huge infusion of cash into the U.S. industry as a result of elevating the foreign ownership limits. And we are talking about, as I heard today, if you are going to increase foreign ownership in U.S. carriers, you are going to have to impose a whole series of regulations on that U.S. carrier in its boardroom as to how it gets controlled by this outside influence. And so, we are talking about another form of re-regulation that now takes place in the boardroom, as opposed to the marketplace.

And so, as far as we are concerned, the issue is short- term liquidity. The solutions are there. The foreign ownership issue on U.S. carriers should be carefully considered, and we are not opposed to raising it. But it should be carefully studied by the Department of Transportation. In our opinion, foreign

route sales are wrong. It just is not the way to approach a very strong, healthy, U.S. aviation industry as it prepares itself to go global.

Senator FORD. Well, you believe the existing statutory provision, as it relates to foreign ownership and control, is sufficient. That's the way I understood you. Or do you believe it should be refined or expanded?

Mr. BEAUVAIS. It can be expanded after careful examination. The 25 percent limit has been there for a long, long time. It may be time to review that, to determine what should be done.

We do not oppose that. But we do feel that it should be very carefully studied before any changes should be made.

Senator FORD. Well, we find that the Secretary is making some decisions that we are concerned about, and apparently you are, too. They're not giving the hearing that Mr. Callison talked about a thorough review. We are not getting the thorough review that we ought to have.

It all relates, and if foreign investment is going to keep you afloat, it worries me a little bit that you have a contract for so many engines from an American company. You'll get foreign investments and they'll just as soon you buy those engines when you have a clause in there to cancel so many out, that you then buy them from their engine maker. There are lots of little things that transpire in the Board room without deregulation going on. That takes away American jobs, and when you take away American jobs, you bother the hell out of me.

So, one of the things that we are getting to here is how much influence is there. If the foreign carriers would put that money that they have put into most airlines into investments and draw interest on it, they would make a lot more money than they are making by investing in the airlines.

This tells me that their reason for investing is to get into our market and get to control some of our airlines. With our problems, it is awfully hard to see a Chrysler bailout today.

Mr. BEAUVAIS. If that is their reason, then I don't think it should be changed. In other words, I don't think the limits ought to be raised.

I think a full investigation of foreign ownership implications and changes in the rules and regulations that the DOT should follow should be carefully considered in light of those conditions.

Senator FORD. Thank you very much.

Senator McCain, I apologize for taking so long.

Senator MCCAIN. No problem, and I apologize to the panel for keeping you here so long. We appreciate your very important testimony.

I have just one comment.

We keep talking about how many airlines are going to be left, and that becomes a self-fulfilling promise after a while. It is of great concern.

But I don't see how you can draw these conclusions any other way when we see the march of events as they are transpiring, certainly recently, as a number of airlines go under.

Pan Am I think has a special name in aviation history. Now we even see it in significant jeopardy.

Mr. Checchi, you say that you believe a plan for the U.S. airline industry, to preserve our Nation's air transportation infrastructure, should be given serious consideration.

I would be interested, perhaps for the record, in what the outlines of that plan should be.

On page 3, you say, "We, at Northwest, have lost much of the financial reserves we had earmarked for expansion of service improvements that we

considered vital to our long- term competitive positions. Like other carriers, we are husbanding our remaining resources to meet an uncertain future."

At the same time, you just bought the Eastern slots and gates at National for $35 million, the Hawaiian routes for $25 million. You had enough money to do that. But yet, you want the Federal Government to have some kind of bail-out plan, which in response to Chairman Ford does not mean "you," it just means all the airlines.

I am very impressed by your concern about other airlines. But, frankly, I don't understand your statements. If I could finish up before you comment, you came to see me at the time of the buy-out of Northwest, and everything was going to be fine. There were no problems. And yet, you are talking about significant problems, even to the point where the United States airline industry should be bailed out by the government in some fashion, which is as yet undetermined.

When somebody goes into a business, Mr. Checchi, they do not plan on everything being just fine. We have had many wars in this century, in fact, we have had wars throughout this Nation's history. The fact that we got into a war which has only lasted 30 days so far, to my reckoning, is now going to cause the collapse of the industry or perhaps destroy your ability to function means to me that you either didn't plan right or you don't read history. I don't know which is the case.

So, I would be interested in your response to those comments. In particular, why in the world, after 30 days of war, should the Federal Government now be bailing out the airline industry?

Mr. CHECCHI. First of all, Senator, I think the record will show that at no time in my testimony did I suggest a bailout by the Federal Government by this industry.

Senator MCCAIN. Maybe I should make a correction, then. But you believe that a plan for the U.S. airline industry to preserve our Nation's air transportation infrastructure should be given serious consideration?

Mr. CHECCHI. Yes. In fact, I believe that's part of what we are here to talk about, that there is national concern about the future and the structure of the industry, and that it does not seem to me to be saying too much to reiterate that yes, I think some planning should go ahead, and that part of that planning is to say what should the shape of that industry look like and what should government policy be, and what kind of government actions should be taken in support of trying to produce that shape.

The apparent anomaly that you speak about, about us husbanding our resources and at the same time buying gates and buying slots, is the fact that this is a competitive industry. It is in a process of consolidation, and part of our task is to put ourselves in a long-term position where we can be competitive with American, Delta and United, who are larger and who have greater consumer preference than we.

So one task is certainly to preserve your liquidity in the short run. But, in the long run, as I have told our people, we cannot find ourselves as the American Motors of the airline industry.

We must put ourselves in a position where, in the long- term, we are as large and as strong as American, Delta, and United. That is why we are doing the things that we are doing.

As far as the war goes, I fully appreciate that the physical hostilities involving this country date back to January 16. But I think that you appreciate that in the 48 hours after August 2, when Iraq rolled into Kuwait, the price of oil doubled. The impact on this industry was immediate and readily apparent.

I think that you appreciate that, with the beginning of hostilities on January 16, the impact on this industry was immediate and substantial.

The threat of terrorism, as far as I can see, the only type of change in human behavior that the threat of terrorism seems to induce is that people stop flying. That is a weapon that has been employed by the enemy, and the effect has been on this industry. And the effect has been a short-term reduction of liquidity, which has resulted in a great number of carriers having to sell routes and do so in a very highly concentrated period. The only thing that I am suggesting is that perhaps one could look to injecting some liquidity as a method by which markets will then have an opportunity to right themselves and perform in a more stable fashion.

Senator MCCAIN. Thank you.

I would also note that the price of oil has come down significantly, as well, as you know, in recent weeks.

I have just one more question that I would like to ask of all the panelists. A brief answer would be appreciated. It is a two part question.

First, is the CRS an impediment to competition? Should the airlines who own the CRS's be forced to divest? Let's start with you, Mr. Beauvais.

Mr. BEAUVAIS. Thank you, Senator McCain.

We feel very strongly about this. It is the foundation of the problem that causes this industry to drift toward unhealthy concentration.

There should be a serious antitrust address to the issue, and, in our opinion, divestiture is called for. It would be good for the industry. It would establish a very highly effective, competitive nature to our business. It would not harm the CRS carrier owners. They would be rewarded much more than the investment that they have made, and it would give the U.S. domestic industry the power to conduct itself very effectively on a worldwide basis.

So there is no downside and there is enormous upside to divestiture.

Senator MCCAIN. Thank you.

Mr. Checchi.

Mr. CHECCHI. Senator, I am not sure that I have an answer. I suspect it would be somewhat dependent upon what the long-term structure of the industry is, how many national carriers there are and how competitively structured they are in the area of routes, slots, and things of this nature.

Senator MCCAIN. May I rephrase the first question and ask it again. Is it presently an impediment to competition?

Mr. CHECCHI. Speaking for Northwest Airlines, I would say that we are in a position where we could be more competitive if we had a larger CRS system. So I could make the presumption that a carrier that is smaller than we and does not have a CRS system is not going to be in as competitively strong a position as we are.

Senator MCCAIN. Thank you.

Mr. Callison.

Mr. CALLISON. Senator McCain, I do not think that the government ought to require divestiture of CRS's. I think that is too drastic a remedy. I think there have been good faith investments made in those systems.

I do think there are some competitive problems with some of the larger CRS systems today. As you know, we have said before, we have said to you, we have to the Department of Transportation that they need to improve their regulation of the CRS systems. They need to address the issue of architectural bias which still exists. They need to address the issue of contracts, length of term of contracts, roll-over clauses, liquidated damages, those sorts of things.

They say they are going to do that soon. But they have said "soon" for an awfully long time. I really think that maybe a little push from Congress would help. But that is what I think needs to be done, regulatory improvement of the environment, but not divestiture.

Senator MCCAIN. Thank you, Mr. Callison. May I just comment before Mr. Talbot responds.

I hate to often testify to the ineffectiveness of Congress, but we have been pushing, and pushing, and pushing on this issue, and so far we have seen nothing for our efforts.

Senator FORD. Secretary Skinner said in his testimony today that he'd have it out in 30 days. Does anybody want to bet?

Mr. CALLISON. Maybe a piece of legislation could be drafted that could go into the hopper on the 31st day if it does not happen. That might actually give matters a little push.

Senator MCCAIN. Thank you.

Mr. Talbot.

Mr. TALBOT. I think computer reservation systems are a definite marketing edge for those who own them. We are on the outside.

There are lots of esoteric arguments that he who develops it is entitled to the fruits of what he develops. But, as a guy on the outside, we are at a distinct competitive disadvantage. Those who have them will always be at an advantage.

I would like to see an outside organization owning and controlling them and selling services fairly to all.

Senator MCCAIN. Thank you.

Thank you all very much.

Thank you, Mr. Chairman.

Senator FORD. Thank you.

On this CRS, it seems to me that a year or so ago, there was an effort made to try to put everybody into the CRS house. The Justice Department I think tried to do something like that.

Senator MCCAIN. Mr. Chairman, I might recollect that both we and the Justice Department decided that was not the answer.

Senator FORD. Yes.

Thank you, gentlemen.

Thank you all very much.

[Whereupon, at 1:41 p.m., the subcommittee adjourned, to reconvene upon the call of the Chair.]

## ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

### STATEMENT OF A. MAURICE MYERS, CHIEF EXECUTIVE OFFICER, ALOHA AIRLINES, INC.

I am A. Maurice Myers, Chief Executive Officer of Aloha Airlines, Inc., and would request that this Subcommittee include Aloha's views on the impact on competition of the Department of Transportation's recent liberalization of the longstanding restrictions against foreign control and ownership of U.S. carriers. I would similarly ask that the Subcommittee also consider Aloha's views on another question which I feel is very much related to the many difficult problems confronting the smaller carriers as they strive to remain effective competitors. That related question concerns the large carrier bias inherent in the Department's carrier selection policy.

Turning to the two issues of principal concern to Aloha. A. It Is Essential that Congress Set Specific Parameters Governing Any Proposed Liberalization of the Established Foreign Ownership and Foreign Control Restrictions

In 1989 and 1990, Aloha, perhaps more than any other carrier, found itself forced to become an expert in the five decades of precedent setting forth the acceptable limits of foreign ownership and control of U.S. carriers. Aloha was a principal party to the often controversial Discovery Airways proceeding in which a new entrant carrier, whose financing derived entirely from a combination of Japanese and British sources and whose principal officers and directors were financially beholden to a Japanese investor, sought to obtain the Department's approval to become a domestic carrier. It was only after a prodigious effort, which succeeded in uncovering the facts surrounding the actual foreign sources of that carrier's entire capital base, that the Department reversed direction and concluded that Discovery was indeed controlled by foreign investors.

More interestingly, even though Discovery has not operated since mid-July 1990, Discovery's Japanese investors have continued to fund Discovery's more than 140 employees, pay the lease payments on all of Discovery's aircraft and pay all of Discovery's other expenses. In the meantime, Discovery's application before the Department remains dormant. Rumors abound that Discovery is either searching for a U.S. citizen prepared to lend his or her name and, perhaps temporarily, some nominal capital to hold the majority of Discovery's voting stock, or that Discovery intends to establish an Employee Stock Ownership Plan funded entirely with Japanese capital.

I have intentionally belabored the Discovery situation to focus on the need for the Subcommittee to enact legislation setting forth clear outer limits for foreign control, as well as the foreign ownership, of U.S. carriers. I would suggest for the Subcommittee's consideration that the degree of permissible foreign control of U.S. carriers should be statutorily limited in at least the following manner.

1. This liberalized foreign control limitation should be allowed only in cases where the foreign investment derives from foreign countries which allow reciprocal U.S. investment and which afford liberal entry, possibly including cabotage rights, to U.S. carriers; and

2. There should be a percentage limit on the total debt and equity capital which can be invested in any U.S. carrier to assure that there is a reasonable measure of U.S. source capital.

These statutory parameters of foreign control would be in addition to the existing 25% limitation on the foreign ownership of a U.S. carrier's voting securities and the requirement that the president and at least two thirds of the Board of Directors also be U.S. citizens.

Aloha cannot overemphasize the importance of a requirement that the homeland country of a foreign investor allow for reciprocal U.S. investment and liberal entry by U.S. carriers. I of course am thinking of such a policy in relation to Japan whose businesses have already acquired control over a significant portion of Hawaii's economy.

In terms of possible reciprocal U.S. investment in Japanese carriers, Aloha's review of Japanese laws indicates that the only relevant written statute or regulation even addressing the subject is a statutory ceiling of 33-1/3% on the number of voting shares which a non- Japanese citizen may own for purposes of aircraft registration. (Art. 4 of the Civil Aeronautics Law) Similarly, a Japanese airline may refuse to enter the name of any non-Japanese shareholder in the shareholder register if that non-Japanese shareholder were to acquire more than 1/3 of the outstanding voting stock. (Art. 120-2, para. 1 of the Civil Aeronautics Law)

Aloha understands that there are no written statutes or regulations governing the acquisition by a non-Japanese lender or investor of control over a Japanese airline. That is not surprising since the

amounts necessary to acquire such "control" are far larger than virtually any non-Japanese investor could put together.[1] As an indication of the staggering amounts that would be required, it would take more than $3.6 billion to just purchase 25% of JAL. That would be equivalent to the size of the 1989 Northwest-Wings Holdings LBO when U.S. airline stocks were rading at record highs. Today, it would be exceedingly difficult to amass that much capital in the United States to purchase a non-controlling 25% interest in JAL's voting stock. It would almost certainly be impossible to amass enough U.S. capital to purchase all the debt and most of the non-voting equity of JAL.

More significantly, even if U.S. capital could be amassed in such amounts, is there any doubt on how the Japanese would react to an attempt by non-Japanese interests to acquire control over JAL or ANA? Japanese investment is not the same as Dutch investment and one way or another, we all know that the Japanese Government would not permit non- Japanese interests to acquire control of any of its major air carriers.

We also know that the U.S.-Japan bilateral agreement is one of the most restricted the United States has. Aloha has been trying for a number of years to obtain entry to the Honolulu-Tokyo market—one of the largest markets by passenger volume in the entire world. If there was ever a market that justified open entry, that is the market. Yet, there always seems to be some excuse or reason why the Japanese Government is not prepared to consider open entry.

It is for all of these reasons that Aloha feels that establishment of reasonable statutory limits on foreign control as well as the preservation of existing statutory limits on foreign ownership are necessary to enhance, rather than retard, competition among U.S. carriers. While some are suggesting that greatly increased foreign investment in U.S. carriers is the answer to the excessive concentration and financial problems facing the industry, I would respectfully suggest that that is not the case for several reasons.

FIRST, with the exception of Discovery, which involves Japanese investors whose decisions are being driven by factors unrelated to the airline itself, I have substantial doubt that most foreign investors would be interested in investing in the weaker U.S. carriers most in need of new capital. The lessons of JAL's investment in Hawaiian as well as SAS' investment in Continental will linger for quite some time. Whatever investment takes place is likely going to be in the far larger U.S. carriers. The odds weigh heavily against the liberalization of the foreign investment restrictions resulting in the restoration of the health of the weaker U.S carriers or otherwise easing the excessive concentration within the industry. Indeed the reverse could be true if foreign investors are free to put their capital in the U.S. mega-carriers whose appeal as "trophy properties" may prove irresistible to foreign investors. That has certainly been the history of resort and hotel investments in the Hawaiian Islands.

SECOND, to allow increased foreign investment means necessarily that we are indirectly allowing investors to enjoy cabotage rights within the United States. Yet, unless the United States has liberal bilateral agreements with the homeland of those foreign investors, which also permits some degree of cabotage for U.S. carriers, increased foreign investment will actually worsen rather than improve the competitive strength of the U.S. carrier industry. As an example, would not the incentive of the Japanese Government to allow U.S. carriers improved access to Japan, possibly including cabotage rights, be greatly reduced if the Government of Japan knew that it could achieve de facto access to any and all U.S. domestic markets through the guise of the liberalized U.S. foreign investment policy. How many times must the United States learn the hard way that many of our major trading partners will only give an inch when absolutely forced to do so.

Competition will be enhanced only by liberalizing the restrictions against foreign ownership and foreign control in return for clearly identifiable improved access to and within foreign countries. Without such a quid pro quo, the industry's already severe problems will only worsen.

B. The Department's Carrier Selection Policy in International Route Proceedings Should Be Revised

The Department's criteria for carrier selection applied in international route proceedings, where there is limited entry, should similarly be revised. The explicit public interest factors enumerated in Section 102 of the Act for international markets do not even include the stated statutory objectives applicable in domestic markets—of:

The encouragement of entry into air transportation markets by new air carriers,

The encouragement of entry into additional air transportation markets by existing air carriers and

The continued strengthening of small air carriers so as to assure a more effective, competitive industry.

While the absence of these objectives in the statutory criteria applicable to international markets has not precluded smaller carriers from receiving occasional international route awards in contested carrier selection proceedings, those occasions have been few and far between. None of the real plums in the three most recent transpacific route proceedings went to any of the smaller carriers. This has occurred because the present carrier selection policy is skewed heavily in favor of the mega-carriers and thus contributes to the excessive concentration which we now find ourselves trying to remedy.

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[1] The equivalent dollar value of JAL's and ANA's issued voting stock was $14.52 billion and $14.06 billion, respectively, based on the yen trading prices as of February 6, 1991.

Whether or not the objectives just mentioned are added to the list of public interest factors governing international air transportation, the Subcommittee should make clear to the Department that its carrier selection criteria should be revised to eliminate the inherent bias favoring the larger carriers. That bias derives from a number of the carrier selection criteria which the Department commonly uses.

The first such factor is the significant decisional weight which the Department accords to the number of beyond-area U.S. cities which can be served with new single-plane and on-line connecting service behind a new route between a U.S. gateway city and a foreign point. In the U.S.-Japan Service Case, in which Aloha pursued the Honolulu-Tokyo route, the fact that Aloha proposed the greatest number of Honolulu-Tokyo seats and was the only carrier which expressed any willingness to pursue a campaign to lower the Honolulu-Tokyo fares was all but ignored. Rather than focus on the pivotal Honolulu-Tokyo market, the Department decided to base its decision in favor of Continental on that carrier's offer to provide Houston-Tokyo single-plane service via Honolulu. The fact that Continental could have provided that same single-plane service on a far more direct and shorter routing via Seattle was discounted inexplicably by the Department.

The Department's carrier selection decisions quite often boil down to which carrier can serve the greatest number of interior U.S. cities. It can surely be appreciated, however, that this market structure criterion favors heavily the megacarriers with their vast route networks.

Another carrier selection factor, although implicit rather then explicit, is the Department's strong preference that the applicant carrier already operate and have available the wide-bodied aircraft which the carrier proposes to use over a particular new route. This was a criticism directed at Aloha, which proposed B-747 service between Honolulu and Tokyo, even though there was never any doubt that Aloha could have financed the acquisition of such aircraft. In substance, the Department all but requires that an applicant gamble on and assume the risk of committing to either purchase or lease two to three new aircraft long before the Department's final decision is made. That implicit criterion again heavily favors the larger carriers, most of whom have large aircraft orders in place.

This criterion makes little sense. It is irrational to expect a prudently managed carrier to take such an investment risk. Any person familiar with the industry would readily acknowledge that a well-financed smaller carrier just awarded a lucrative international route could easily find suitable aircraft. That is certainly the case with Aloha.

Closely related to the "aircraft-on-order" criterion is the now standard condition that the new service must be started within 90 days—a time period which is often too short to locate, acquire and refit long range aircraft and also arrange for the necessary pilot training. While I can appreciate that there is a minuscule short-term benefit to having new service commence several weeks sooner than might otherwise be the case, the importance of "winning the race to the starting line" does not compare to the pro- competitive benefit of injecting new competition from a smaller carrier, for whom the new route would represent a major new undertaking. For a carrier such as Aloha, the award of a major international route such as the Honolulu-Tokyo route would have provided significant benefits throughout our entire system and would have made Aloha an even stronger competitor over our existing system. That is and should be an undeniable long term- public interest benefit.

The Subcommittee should enact legislation mandating that the Department revise its carrier selection criteria to establish a presumption of significant competitive benefits to be derived from the selection of a smaller carrier when a proposed new route would represent a significant portion of that carrier's system. The Subcommittee should also direct the Department not to rely on the so-called beyond area benefit criterion, the "aircraft-on-order" criterion, or the 90 day start-up condition when, on the basis of the other traditional criteria, the carrier selection decision is narrowed to a choice between a large and small carrier. Without at least a partial leveling of the playing field in the Department's carrier selection route proceedings, smaller carriers will be increasingly left behind as the size differential between those carriers and the mega-carriers increases.

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## STATEMENT OF RAYMOND J. VECCI, CHIEF EXECUTIVE OFFICER, ALASKA AIRLINES, INC.

Although I will not be appearing before the Subcommittee to deliver oral testimony, I nevertheless feel strongly about the principal issues which the Subcommittee will be addressing—the Department of Transportation's route transfer policy and the Department's recent liberalization of certain longstanding restrictions prohibiting foreign control over U.S. carriers. would ask that my written testimony be considered and accepted for the record.

Although the hearing agenda does not indicate that the Subcommittee will also be considering the impact of the Department's inaction on the important question of computer reservation system booking fees, each of these issues—the Department's route transfer policy, the relaxation of certain foreign control restrictions and the unchecked market power of the dominant computer reservation systems—all relate to the overriding question facing Congress, the Department and the industry. That question is whether Congress and/or the Department is prepared to take minimal corrective steps to stem the industry's every-increasing concentration by reducing the playing field tilt which makes it

so difficult for the few remaining non-mega carriers, of which Alaska is one, to remain effective competitors.

Alaska is well aware of the fact that it is a small carrier—even though its 1990 revenues, including those of its affiliated regional carrier, exceeded $1 billion. Alaska is also quite proud that it was just selected as Airline of the Year by Air Transport World. Alaska also knows that being only 1/13 the size of the mega-carriers means that Alaska does not have the same purchasing and marketing power. We pay more than do the mega- carries for many of the items and services we purchase. We also face a number of marketing disadvantages because of our small size.

All of these costs and marketing disadvantages are difficult challenges and we fight them every day. But there is no reason in the world why, in addition to these burdens which have so disproportionately affected the smaller carriers, we should also be required to cope with regulatory inaction or misguided regulatory policy. The smaller carriers have dwindled in number and it was only a few days ago that one of the well-known smaller carriers was forced to suspend debt and interest payments because of increased financial pressures.

The industry's problems and how the smaller carriers stand to be affected cannot await more temporizing. Solutions must be found if there is to be a successful rebirth of competition.

The topics I address are:

1. The Department's pro-route transfer policy is heavily skewed in favor of the mega-carriers and should be revised to require contemporaneous consideration of credible competing applications;

2. The relaxation of the foreign ownership and foreign control prohibitions effectively means that foreign interests will have cabotage rights; and

3. How the Department's continued unwillingness to place any restraints on the level of computer reservation system booking fees is forcing the smaller carriers to continue their massive revenue transfers to the mega-carriers.

THE DEPARTMENT'S PRO-ROUTE TRANSFER POLICY IS HEAVILY SKEWED IN FAVOR OF THE MEGA-CARIERS AND SHOULD BE REVISED TO REQUIRE THE DEPARTMENT TO CONSIDER CREDIBLE COMPETING APPLICATIONS

A review of the Department's processing of large scale route transfers as far back as the 1985 United-Pan Am Pacific Route Division indicates that the Department has approved each and every such transfer. The only conditions imposed on any large scale route transfer involved a conditional review of United's Seattle-Tokyo route largely because of Department of Justice pressures and a decision not to transfer Eastern's Miami/Tampa-Toronto authority to American because those routes had been seriously underserved. Except for these limited instances, every route transfer has been approved without exception.

This policy of almost certain approval has very much worked to the considerable advantage of the very largest carriers which have the "deep pocket" resources to outbid any smaller carrier. The clear result has been to concentrate in the hands of American and United in particular large chunks of route authority which these carriers would never have otherwise obtained in carrier selection route proceedings. Does anyone doubt for a moment that United would not have obtained all of Pan American's U.S.-Tokyo routes had these routes been considered in carrier selection proceedings?

What is happened is that the dollars offered by the buyers usually coupled with the seller's stated urgent need for capital has overwhelmed the public interest. It also means that enormous blocks of international route authority in the Pacific, Latin American and now Europe will be acquired overnight in what are accelerated route transfer proceedings. Most importantly, it means that this process is also increasing the rate of concentration within the industry at breakneck speed.

Congress should act to require the Department to modify its route transfer policy in order to allow the smaller carriers to compete effectively for these valuable international routes. The Department should be required to consider all credible competing applications in a comparative carrier selection proceeding along with the route transfer application. Under such a format, the carrier with the best service and fare proposal-not necessary the carrier with the deepest pocket- -would be selected to operate over a particular route, there is no question that under such a format that certain of the routes now comprising the large route transfer packages would be awarded to non-mega-carriers.

The Subcommittee should understand that it is not too late to take action to correct the Department's route transfer policy. There almost certainly will be other proposed route transfers as the financially weaker carriers attempt to cash out in order to stem the financial pressures they are facing. If Congress does nothing, the results are inevitable. Such inaction would disserve the public interest.

Alaska recognizes that adoption of its proposal might result in the creditors of the smaller carriers receiving less than top dollar. But it is the public interest and not the private interest of these creditors which should be of paramount concern. Requiring the Department to revise its route transfer policy to maximize rather than minimize the number of U.S. carriers serving important international markets is an essential objective which over the long term will best serve the needs of American travellers and the overall public interest.

THE LIKELY EFFECT OF THE DEPARTMENT'S DECISION TO LIBERALIZE THE FOREIGN OWNERSHIP AND CONTROL RESTRICTIONS OPENS UP THE BACKDOOR TO CABOTAGE RIGHTS

I find it extremely difficult to believe that the Department's recent liberalization of the foreign control restrictions will prove to be a panacea as others seem to be suggesting. Well-heeled foreign investors are far more likely to invest in the stronger mega-carriers than in the weaker carriers in the industry. I cannot believe that SAS, for example, would make the same decision today to invest in Continental if it then knew about Continental's present situation.

My principal concern is that liberalization of the foreign ownership and control restrictions should only take place if there is a high degree of certainty that there will be clear and demonstrable public benefits for the industry as a whole as well as an improvement in competition. I am aware of no empirical evidence that will support a conclusion one way or the other. There is surely none in the Department's recent decision.

Until a carefully considered objective analysis has been completed, I would suggest that the Department be advised that there are to be no further instances where increased foreign ownership and control will be permitted until Congress has acted. If legislation is necessary to make absolutely certain that there are no further such instances, then I would be in favor of such legislation until there has been a thorough evaluation of the ramifications of a change in the foreign ownership and control restrictions.

Among the questions that such an evaluation must address are:

1. Should an increase in foreign investment be limited to those investors whose homeland countries have granted significant and clearly defined benefits to U.S. carriers?

2. Should any liberalization of the foreign ownership issue await Congressional action on whether to also liberalize the current cabotage restriction?

I do not see how there can be an informed decision about liberalizing the foreign ownership restrictions without contemporaneous consideration of the cabotage issue. One can simply not allow a foreign investor to purchase most of a U.S. carrier's non-voting equity and debt as well as 25 percent of that carrier's voting securities and ignore the real world impact of such a substantial investment. An investment of that magnitude cannot help but transfer control. The entity which provides the major source of capital will inevitably have a significant voice in how the borrower runs his business. A foreign investor in such an instance is buying access to, and profits from, any and all of our principal domestic markets. By any other name, that is cabotage without a change in the logo on the airplane. For that reason, until the statutory cabotage prohibition is changed, which is a matter for Congress and Congress alone to decide, this Subcommittee must take whatever action is necessary to prohibit any further indirect grants of cabotage through the guise of liberalization of foreign ownership and control restrictions.

Please understand that I am not irrevocably committed to a blanket cabotage prohibition or to perpetuation of the current foreign ownership and control restrictions. But I do not want to see a decision on these important questions made on the basis of one carrier's situation or even on the basis that a particular foreign country permits unrestricted reciprocal investment by U.S. investors.

Once again, whatever the Subcommittee finally decides to do, the Subcommittee should put forth a clear directive to the Department that there are to be no further instances where liberalized foreign investment or foreign control is permitted, until Congress has concluded the thorough deliberation which this issue deserves.

THE DEPARTMENT'S CONTINUED INACTION WITH RESPECT TO THE COMPUTER RESERVATION SYSTEM ISSUE MUST BE CORRECTED

The computer reservation system problem first surfaced at the Department of Justice in 1982 and has been studied and restudied by the Department of Justice, the former Civil Aeronautics Board, the Government Accounting Office, other committees of Congress and by a number of U.S. courts. In spite of all that study and the implementation in 1984 by the Civil Aeronautics Board of the so-called "CRS Rule" prohibiting overt carrier-specific display bias and mandating uniform booking fees, nothing of substance has changed. Non-CRS vendor-carriers and, to a lesser extent, the smaller CRS vendor-carriers, are still transferring hundreds of millions of dollars in revenue each year to the principal CRS vendor-carriers—American and United. The present $2.25 booking fee is at least twice the level of any reasonably objective estimate of the properly allocable costs incurred by the two principal CRS vendor-carriers in providing reservations services. The Department of Transportation's 1988 CRS Report, which probably set new standards for understatement, found that the booking fees charged by Sabre and Apollo are no less than 200% of their allocable costs.[1]

The Government's Accounting Office's Report recently estimated that the cash flows of both American and United were increased by more than $600 million mostly as a result of the exorbitant booking fees which other carriers must pay for access to Sabre and Apollo. Those same hundreds of millions of dollars in revenues—if the non-CRS vendor-carriers were not compelled to hand them over to the principal CRS vendor-carriers- -could and would be used to acquire new aircraft, open new stations, operate more flights and carry more passengers. But instead, this massive and highly anti-competitive subsidy being paid by the non-CRS vendor- carriers to the CRS vendor-carriers only fuels their already considerable market power and the ever increasing disparity in size between those

[1] Study of Computer Airline Reservations Systems, May 1988, at 110.

carriers and the smaller non-CRS vendor-carriers, such as Alaska.[2] Although there has been much previous discussion about CRS divestiture, that remedy appears to be on the back-burner. Indeed, whatever proposed changes the Department was going to announce in the form of a Notice of Proposed Ruling are understood to be contained in a voluminous report which has been bottled up by the Office of Management and Budget for a number of months. Although Alaska has not seen that report, we understand that OMB's objections are apparently premised on the notion that one or more of the Department's recommendations are "overly regulatory." That impasse should be quickly brought to an end and the issues should be explored thoroughly by the Subcommittee. OMB should not be permitted to continue acting as a roadblock to any improvement, however minimal, in the CRS problem.

The most serious and as yet unresolved problem is the level of the CRS booking fees which the non-CRS vendor-carriers must pay to principally American and United. Even if the Department, as we assume to be the case, is unwilling to consider regulating booking fees, there must be some outside voice that can decide objectively whether those fees, and what are undoubtedly going to be further increases, are reasonably related to Sabre's and Apollo's costs of providing reservations services.

The solution which Alaska would recommend is that Congress, by statute, or the Department, by regulation, mandate that any disputes about the level of CRS booking fees be referred for mandatory arbitration at the request of either the CRS vendor-carrier or the non-CRS vendor-carrier. Although the first such arbitration proceeding may be rather complex and may even break new ground, the strong likelihood is that the guidance gleaned from that decision would have the salutary effect of serving as a brake on further unwarranted CRS booking fee increases as well as any unwarranted expectations by the non-CRS vendor-carriers about what a reasonable fee for those services would be.

We are aware that this solution has been proposed in the past and has died for lack of consensus. We do not feel that a consensus should be a condition precedent. Allowing the status quo to remain is unacceptable. But for the Depatment's pending review of the CRS Rule, it is likely that the CRS vendor-carriers would have raised their fees beyond even their current levels. To appreciate the market power the CRS plays in the hands of the CRS vendor-carrier, it need only be recalled that implementation of the CRS Rule in November 1984 was accompanied by a 600% increase in the average booking fee then being paid by the non- CRS vendor-carrier from approximately 30 cents per booking to $1.85. Yet not one of the non-CRS vendor-carriers gave more than momentary consideration to not continuing to participate in the CRSs and paying the 600% price increase. That fact alone speaks volumes about the market power of the two principal CRSs, which has shown no size of abating. In fact, there have been a number of recent articles about how the survival of the smallest of the four remaining CRSs is threatened and there is very little expectation that system will remain.

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## STATEMENT OF VICTORIA L. FRANKOVICH, PRESIDENT, INDEPENDENT FEDERATION OF FLIGHT ATTENDANTS

My name is Victoria Frankovich and I am President of the Independent Federation of Flight Attendants, representing TWA employees. We are submitting this testimony because we have an enduring interest in the long-term survival of our employer, the communities it serves, and our jobs, and are deeply concerned with certain structural problems that are plaguing TWA and the entire airline industry.

We will first discuss the issue of greatest concern to us—the proposed sale to American Airlines of TWA's entire London route system. We will then explain why the DOT's recent practice of "rubber-stamping" proposed route transfers may well exacerbate rather than alleviate the financial problems being encountered by several major air carriers. Route sales will not eliminate financial difficulties caused by crushing debt. The practice of giving carriers virtual in the disposition of their limited entry routes may aggravate this trend. IFFA then illustrates how TWA's employees, the communities it serves and its passengers will all be hurt if the proposed American-TWA route sale is permitted to go forward. Congress must ensure that the DOT adheres to its statutory mandate to approve only those route transfers which enhance competition and leave both the buyer and seller economically viable. Using this standard, the DOT could not approve the American-TWA route transfer proposal.

I. The Sale of TWA's London Routes to American Airlines Will Destroy TWA

Citing financial difficulties, TWA has sold or proposes to sell to American Airlines some of its most profitable routes—its Chicago-London route, which has already been sold, and the remainder of its United States-London route system, the sale of which is now under consideration by DOT.

The key to TWA's survival lies not in the sale of its lifeblood—its lucrative Transatlantic routes—but in the retention of those routes and the rest of the TWA route system which benefits from the transatlantic traffic flow.

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[2] The DOT's CRS Report estimates that American's and United's cash flows were increased by almost $600 million dollars in 1989 because of the level of booking fees charged by those CRS vendor-carriers. CRS Report, supra at 79.

The Department has approved an avalanche of route transfers, indicating that approval was necessary to stem losses caused by increased fuel prices and a sudden and dramatic decrease in passenger air travel. It is critical that the DOT not react hysterically to all proposals to sell routes, since the underlying reasons for and effects of those transactions vary enormously. TWA can survive, but not if the Department approves the sale of the remainder of TWA's London routes.

Sale of certain profitable limited-entry international routes will likely eliminate airlines that are selling routes, and diminish the economic viability of those carriers that could not compete in the bidding oar. Many carriers which seek to sell their assets will inevitably fail. This dim prognosis is not likely to change in the short term, unless DOT pinpoints the real causes of the airlines' financial difficulties and develops an effective means of dealing with them.

2. The Recent Wave of Carrier Bankruptcies Has Been Caused by Excessive Debt.

The problem in the airline industry today is leverage. not labor. According to statistics published in the February 13 edition of the Aviation Daily, the common thread among the sickest carriers in the airline industry is crushing debt, not high labor costs. According to statistics compiled by Salomon Brothers, TWA's long-term debt comprised 114.8% of the carrier's entire capitalization in 1989. Continental's long-term debt weighed in at 96. 3%. By contrast, Delta's long-term debt comprised only 18.3% of the carrier's total capitalization, and American Airlines' debt was a modest 33.5% of total capitalization.

On the other hand, recent attempts to make labor unions the scapegoat for the current industry downturn ignore the fact that there is no correlation between a carrier's labor costs and its overall financial health. In fact, TWA and Continental have the lowest overall wages for the industry, and the highest paid employees are those of Delta and American, which are the financially strongest U.S. carriers. Moreover, the labor costs of the U.S. airlines are generally lower than those of European and Canadian carriers.

a. TWA's financial ills were created by the 1988 privatization of TWA.

Recent comments by Secretary Skinner do not acknowledge DOT's pivotal role in promoting TWA's alleged financial distress and other airline failures. Beginning in 1985, TWA employees have made sacrifices to keep the airline viable, while its management has been stripping its assets and failing to make necessary capital investments. TWA employees have understandably refused to cooperate with these efforts to liquidate the airline.

In 1988, TWA employees asked the Department to intervene to block the privatization scheme that left TWA with a negative net worth, interest of $467 million per year, insufficient interest coverage from operations, and $2.6 billion in, debt, while paying the Icahn Entities $467 million in cash and $196 million in preferred securities.

TWA employees accurately predicted that the leveraged buy-out of TWA to bring it under the private control of Carl Icahn, left the airline vulnerable to recession and fuel price increases, both of which are commonplace in the airline industry. The debt incurred by the Icahn Group since acquiring TWA in 1985 has ensured, even in the best of times, that the carrier's operating profits would not be reinvested in airline operations. TWA employees warned DOT that the over-leveraging of the company strongly indicated Mr. Icahn's intent to dismantle TWA. Unfortunately, these warnings have been prophetic.

Because of TWA's low labor costs, the airline is ordinarily able to post operating profits. Its losses are attributable to the high fixed costs of servicing debt incurred for no legitimate airline-related business purpose. It is perplexing and frustrating that DOT would react to TWA's self inflicted financial difficulties by approving asset sales that will worsen the carrier's financial situation. This outcome is not driven by the marketplace but is rather the predictable result of DOT's regulatory decision to turn a blind eye toward a carrier's imprudent financial practices. Secretary Skinner seems to believe that wage reductions are the answer to the airline industry's problems. TWA is dramatic proof that high wages are not the problem and lower wages are not the cure. Rather, DOT should exercise meaningful oversight of air carrier financial fitness and adopt policies that encourage investment or corporate restructuring, rather than its current policy, which rewards disinvestment in the airline.

The extent to which the privatization debt and other intracorporate transactions involving the Icahn group may be contributing to the claimed financial problems of TWA is difficult to precisely quantify. Even though we do not dispute TWA maybe losing some money, TWA employees strongly believe that TWA will never make money in the future if TWA's vital transatlantic authorities are sold. For this reason, we must oppose this route sale.

Mr. Icahn had previously assured DOT in connection with a proposed inquiry into TWA's fitness that he would ensure that sufficient assets would be invested in the carrier to ensure its financial well-being. Time has belied these assurances. Given TWA's current claims of financial distress, it is time to determine whether TWA assets have been sold to other Icahn- controlled companies, and, if so, on what terms?[1]

[1] These are the same type of questions DOT was asked to examine with respect to Eastern Airlines. By the time the Trustee for Eastern Airlines was able to secure a monetary settlement relating to impermissible intracorporate transactions, the damage had already been done and Eastern Airlines had by that time ceased to have the resources necessary to remain a viable airline competitor.

Are TWA's long-term prospects as an airline being sacrificed to protect Carl Icahn's cash and position in USX stock? What assurance is there that, having once realized the value of TWA's international routes through route sales, Carl Icahn will not simply liquidate the airline? In April, 1990, TWA filed an exhibit in a route proceeding claiming to have available $1.159 billion in cash and liquid assets. In a recent route proceeding, Chief Operating Officer William Hoar stated in sworn testimony that TWA had plenty of cash. The inconsistencies in TWA's story give rise to the inference that there is more to TWA's financial troubles than meets the eye. To date, the DOT has steadfastly declined to address these questions, claiming that the DOT need not involve itself in "labor-management disputes." But DOT has abandoned its statutory mandate and has impermissibly chosen sides by deferring to carrier management instead of performing an independent, factually oriented analysis of the public interest. It is not too late for TWA, but it soon will be, if DOT hastily approves the transfer of TWA's vital transatlantic route authorities and assets at various U.S. airports.

3. The Department's Permissive Stance Toward Route Transfers Would Doom TWA and Further Weaken the Airline Industry.

Although the sale of TWA's Chicago-London route to American appears to be a fait accompli, the sale of the heart of TWA's route system is now under consideration by the Department. At TWA, and potentially as well as at other financially-stressed airlines, the assets and routes that are being sold are the ones that generate the revenue needed to service the airline's debt.

Sales of vital international routes and valuable airline assets do not necessarily allow airlines to survive. In certain circumstances, when a carrier sells a route that was experimental or not central to its overall market plan, a route sale could conceivably benefit the carrier in the long run. However, in cases like TWA's, the sale of the heart of the carrier's system signals only its financial ruin. With fixed debt and diminished revenues, operating losses will mount. At best, the proposed route sale will postpone TWA's day of reckoning, but will doom the airline's chance of surviving or diminish its value to any prospective acquiror.

The Department's permissive policy toward route sales may well have contributed to on unhealthy "pay as you go" attitude. Asset sales allow an airline to remain afloat, but protect airline managers from having to address the true causes of their financial difficulties. The lessons of the past are clear: Disposal of valuable capital assets and routes have done nothing to revive struggling airlines. TWA's sale of its Chicago-London route is a manifestation of the same syndrome, giving TWA some ready cash but doing nothing to address its overwhelming need for additional capital investment. TWA has taken this shortsightedness to its extreme, and now proposes to sell what is universally perceived as the cornerstone of its entire route system in an effort to preserve the cash and securities positions of the Icahn entities and to obtain more cash today, regardless of the consequences for TWA in the future.

The Department's laissez faire attitude toward route transfers is at least partially responsible for the industry's financial ills. By rubber-stamping countless route transfer applications, the Department has permitted the creation of a secondary market in airline routes. Several carriers have taken on staggering amounts of debt that are secured by government-created "assets," such as limited entry international routes and air carrier landing slots. Institutional lenders will extend credit secured by those routes or slots only if they can be transferred or disposed of at will.

As Congress recently recognized when it amended Section 401(h) of the Federal Aviation Act, the better public policy would be to carefully scrutinize the facts of each route transfer, and authorize the transfer only if the transfer will enhance domestic and international airline competition and only if the transaction leaves both the buyer and the seller intact and viable. The recent amendments to 401(h) will hopefully have the desired effect of forcing the Department to focus on the competitive and structural issues posed by route transfer, and of weakening the "market" in government issued routes and slots.

Although proponents of the laissez faire policy assert that their approach is consistent with the overall goals of airline deregulation, the opposite is true. Although carriers should be permitted to base their decisions to serve any particular route or city pair on market factors, it does not necessarily follow that routes should be "handed off" in private transactions without any in-depth consideration of whether the service proposed by the acquiring carrier will serve the public interest.

The laissez faire policy has led to a concentration of routes in the hands of the nation's richest carriers. Some of these transfers may well be rational and benefit travelers and consumers. However, wealthy carriers may acquire a route, slot or limited access facility merely to prevent its competitors from establishing a foothold there, which surely contravenes the public interest. Heightened Departmental scrutiny is needed to ensure that public as well as private interests are furthered by proposed route transfers.

Congress has instructed the DOT to promote airline competition in all its regulatory functions.[2] Yet, when reviewing route transfer applications, the DOT virtually always accords greater weight to the desires of carrier management than to the interests of communities, the traveling public, and airline employees. It is perhaps reasonable to suppose that airline managers would make better decisions about what markets to serve and prices to charge than regulatory agencies.

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[2] See, e.g. 49 U.S.C. §§1302(a) (4), (7), (9) & (10). How is it that the Department will decline to grant new route authority to an airline in a carrier selection case because the public interest would be better served by promoting airline competition, yet the disappointed applicant can turn around the next day and buy that same route, and the DOT will then to assess the effects on airline competition?

However, professional airline managers would not choose to cannibalize their most valuable operating assets but for financial pressures that have been created by inordinate amounts of debt.

4. Congress Must Ensure That the Department Properly Analyzes the Long-Term Effects of Proposed Route Transfers.

While IFFA is understandably concerned that the dismantling of TWA will jeopardize the jobs of its membership, the losses threatened by the proposed London route sale would be even more far-reaching. Airline passengers are invariably hurt by the loss of a carrier. They lose valuable service options, and are often forced to pay higher fares to travel from point to point. Consumers frequently become unwitting unsecured creditors of the airlines when airlines fail and consumers are left holding worthless tickets.

The communities served by TWA will also be prejudiced if TWA is allowed to dispose of the lifeblood of its route system, and, as a consequence, goes out of business. Hub cities such as St. Louis currently enjoy levels of service that would be lost if TWA were liquidated. These cities can look to become mere spokes of another carrier's hub if the trend toward consolidation continues unabated. The loss of airline jobs will also affect the local economies as the number of airline competitors contracts. IFFA is concerned that loss of airline services and fare increases will lead cities and airline passengers to demand expanded access of foreign carriers to domestic U.S. markets. This is no solution to a problem that can be avoided by preventing the further erosion of the U.S. airline industry.

IFFA understands that Congress shares many of its concerns about the "feeding frenzy" that has beset the airline industry, and has at least partially addressed those concerns by amending section 401(h) of the Federal Aviation Act.

In documents filed with the Department of Transportation, IFFA has demonstrated that the proposed sale of TWA's London route system would contravene each of the policies endorsed in section 401(h). The proposed transfer of TWA's transatlantic operations and Chicago facilities will inevitably result in TWA's elimination as a U.S. airline. American's control over several key London gateways and over critical facilities at O'Hare will give American a stranglehold over the Transatlantic routes and will eliminate TWA's competition on domestic routes serving Chicago's O'Hare Airport. Given Mr. Skinner's reaffirmation of the DOT's commitment to preserving airline competition, we are hopeful that DOT will carefully consider the application of these standards to the joint application of American Airlines and TWA and deny the application.

However, IFFA is concerned by the Department's recent handling of 401(h) transfer cases, and questions whether the DOT intends to implement Congressional directives to consider the effects of route transfers on the domestic U.S. airline industry, the viability of each carrier party to the transaction, and the competitiveness of the U.S. airline industry in foreign markets. Accordingly, Congress may wish to consider further legislation to ensure compliance with the spirit and the letter of the new law.

5. DOT Route Transfer Policies Are Unfair to Airline Employees.

If DOT adopts policies that do not maintain the competitive viability of the airline with which an employee is currently serving, then IFFA believes that some form of relief must be fashioned to avoid undue hardship to the employees of the failed airlines. The promises made to airline employees in connection with airline deregulation have not been kept. At a minimum, employees should enjoy the right of first-hire, which had been part of the Airline Deregulation Act.

A more equitable requirement would be to insure that the people who are performing a function today go with the jobs that are being transferred. TWA flight attendants are highly skilled and experienced personnel. Despite years of loyal service, they enjoy no preference in hiring at American Airlines and will lose wage seniority and certain pension benefits.

The DOT has steadfastly refused to impose the so-called standard Allegheny-Mohawk labor protective provisions for close to a decade. During this time, Congress has attempted to legislate these benefits on a number of occasions, without success. IFFA urges the Subcommittee to consider enacting limited job preservation legislation that would provide the first right of hire to employees who had served on routes to be transferred. These employees should be permitted to retain their seniority for purposes of bidding on routes, to maintain their existing level of wages, and to credit their years of service toward vesting in the acquiring company's pension plan. Since the airlines selling routes have all secured wage concessions from their employees, the employees transferring with the routes would in all likelihood be "less costly" than similarly experienced flight attendants in the acquiring carrier. Of course, IFFA would much prefer to see TWA be maintained as a viable airline competitor.

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## STATEMENT OF RICHARD D. MATHIAS SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, PAN AMERICAN WORLD AIRWAYS, INC.

The U.S. airline industry has a number of long term problems, but the greatest long term problem is surviving the short term.

Pan Am's financial problems are well known, but what the Committee must realize about those problems is that they are no longer unique to Pan Am. Because of the Gulf Crisis and war, every U.S. airline is experiencing a severe financial crisis to one extent or another. The real issue is what will

our air transportation system look like in 1992 and beyond - and that question has to be answered in the next few months.

THE EXTENT OF THE PRESENT CRISIS

The current financial position of the U.S. industry as a whole has never, ever been worse. The majority of U.S. airlines are desperately short of working capital and are experiencing negative cash flows. As Pan Am can testify on the basis of its own experience, once an airline is in this cycle, the rapidity of the decline leaves few alternatives other than the disposition of assets, the limitation of operations and, finally the protection of the Bankruptcy Code.

In December 1990 American, United and Delta - the only three airlines which clearly have the financial wherewithal to weather the current crisis - accounted for approximately 48% of the industry's revenue passenger miles. It is probable that unless immediate measures are taken to assist the industry the Big Threes share could increase to two-thirds or more by this time next year and continue to grow rapidly thereafter.

THE CAUSES OF THE CRISIS

The U.S. airline industry is unfortunately in a position to become the most significant commercial casualty of the war. Air transportation is energy dependent, and the enormous increases in the price of jet fuel gave rise to previously unimaginable losses in the Fourth Quarter of 1990. For Pan Am alone, the fuel price increase resulted in additional expenditures of over $140 million more than normal during the five months of August through December, 1990. Even though there never was any shortage of either crude oil or refined jet fuel, the so-called "free market" has still not returned prices to normal or justifiable levels. For Pan Am, which buys proportionately more fuel at foreign points where fuel prices are higher than in the U.S., our system average price is still 50% higher than it was last July before the Gulf crisis began.

The second principal cause of the industry's financial crisis is the recession. Although we can't quantify the economic effect of lost revenues as precisely as we measure the cash drain of fuel costs, the downturn in the economy in the U.S., and Europe has been a serious blow. The recession has severely reduced traffic and made it impossible to pass through to customers the higher costs of fuel. Also, the deep concerns of individuals, families, and business of all sizes about their financial stability contribute to an alarming reaction to the threat of terrorism, which is the third principal cause of the industry crisis.

Air transportation is dependent to a very substantial extent on discretionary travel. Indeed, we are now seeing that even the bedrock business travel is, to a significant extent, discretionary. Pan Am has previously felt the consequences of indiscriminate terrorist brutality. Now the entire industry is feeling those consequences. We understand that transatlantic traffic on all airlines is down over last year by approximately 50% and most, if not all, of that is attributable to the war and the threat of terrorism. We understand that transpacific travel is down by about 15% to 20%. The domestic consequences have not been as great but are still significant. Go out to any airport and look around. At peak times at every terminal, it looks like early Sunday morning. The safety worry is not going to be resolved immediately by a Coalition victory in the Gulf. Indeed, because of the perverse nature of terrorism such a victory might actually exacerbate the problem for a period.

I must add that the greatest problem with terrorism is the threat. We have confidence in the heightened security procedures which have been adopted, and a lot has been learned and accomplished in the last few years. Nonetheless, until the confidence of travellers is completely restored, the U.S. airline industry will continue to experience a severe revenue shortfall.

THE CONSEQUENCES OF INCREASED CONCENTRATION

Increased concentration is clearly inconsistent with the airline deregulation. Take a look at the primary economic goals of deregulation as written into the law,[1] the availability of a variety of adequate, economic, efficient, and low-price services by air carriers and foreign air carriers; the placement of maximum reliance on competitive market forces and on actual and potential competition; the encouragement, development, and maintenance of an air transportation system relying on actual and potential competition to provide efficiency, innovation, and low prices, and to determine the variety quality and price of air transportation services; and the encouragement of entry into air transportation markets by new air carriers, the encouragement of entry into additional air transportation markets by existing air carriers, and the continued strengthening of small air carriers so as to assure a more effective, competitive airline industry.

Not one of those goals is consistent with an industry where the three largest airlines control two-thirds or more of the business.

At the consumer level, the most obvious result of increased concentration will be higher fares, both through actual increase and the decreased availability of various types of discounts.

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[1] Section 102(a) of the Federal Aviation Act, 49 U.S.C. 21302(a).

There are few industries today that are as price competitive as the airline industry. The types of marginal cost pricing originally envisioned by the drafters of the Deregulation Act exist because of the smaller airlines and the actual and potential competitive threat they pose to the Big Three. But as the industry concentrates and becomes a tightly- knit club, that is going to disappear. From the standpoint of fares, you simply must have competitors to have competition.

From the standpoint of service, there is unlikely to be a shortage of total capacity but the question is how and where will that capacity be deployed? The saving grace from a service standpoint, of the post- deregulation hub and spoke systems is that there are so many hubs - more than twenty. As many of those hubs are weakened or abandoned, more and more communities, many of them large, will find themselves with highly inconvenient connecting service in even their largest city-pair markets.

INCREASED FOREIGN INVESTMENT

The Department of Transportation's recently announced policy with respect to foreign investment in U.S. airlines does not really create new law. What it does, and this step was welcome is to create something of a safe harbor out of number of confusing precedents. Two comments with respect to the Department's action.

First, there is nothing inherently wrong with persons who are not citizens of the United States providing capital for the maintenance and expansion of U.S. airlines and the U.S. jobs created by those companies. The subsidy and national security concerns underlying the U.S. citizenship requirement in the current law are thirty to forty years out of synch with the facts. The airline, shipping and telecommunications industries are the only remaining U.S. industries with significant barriers to foreign investment, and the similar citizenship definitions in the shipping and telecommunications industries are applied in such a way as to permit meaningful foreign investment.

Capital is capital, without regard to its source. Capital creates and preserves jobs. Capital creates airline competition. To the extent that the U.S. airline industry remains an attractive long term investment for persons outside the U.S., everything possible should be done to encourage such investment. @PARA8 = We have already seen major benefits from foreign investment in America West, Northwest and Continental. In our view, the Congress ought to support the DOT's recent policy statement and move promptly to expand such opportunities. Specifically the Congress should reduce the requirement of U.S. citizen ownership of voting securities from 75% to 55% or 51%. Alternatively the Congress should give the DOT Secretary discretionary power to exempt transactions involving foreign investment up to the 45% or 49% level where certain public interest goals are met. These policy goals would be the preservation of U.S. airline jobs, the necessary strengthening of U.S. carrier competition, and the promotion of a more balanced U.S. airline industry.

This is probably the single most effective step the Congress could take to reach these goals. Our critical need is for new capital infusions and we must search beyond our U.S. geographic boundaries to find additional investors.

CRS REGULATION

There is no question that the dominance of the retail distribution network achieved by American and United through their SABRE and APOLLO computer reservations systems has had an adverse impact on airline competition. It has affected market share, it has affected distribution patterns and it has also substantially increased the costs of their competitors.

Pan Am, for example, pays approximately $1.3 million per month to SABRE and APOLLO for Pan Am passengers booked through travel agents using those systems. The real price per passenger booked exceeds $2.50 for each segment of the passenger's trip. There is no real debate that these fees are excessive. Based on the DOT factual studies, a conservative estimate would be that they are at least twice the actual costs plus a reasonable profit, but we have no choice - we either pay the fees or lose the traffic.

The Department of Transportation has had proposals to strengthen the CRS rules before it for over one year. Secretary Skinner recently indicated that they would act on those proposals "soon." We welcome whatever action the Department can take to make the rules more effective, but it will all be temporizing unless the department is prepared to address the monopoly pricing issue. I would add that even if the Department were finally prepared to address that issue and the booking fees were lowered to fair levels, that alone would be only a small step in dealing with the immediate capital crisis.

THE SALE OF INTERNATIONAL ROUTES

The Department presently approaches route sales and transfers on a case- by-case basis. The inquiry in each case is the same. Will the sale and transfer promote competition by maintaining the viability of the selling airline while maintaining effective U.S. flag competition on the route? Pan Am obviously endorses this policy.

The suggestion that there is something per se wrong with selling international route authority ignores several crucial facts. First, usually the selling airline has invested heavily over many years in development of the route and has built the business. Secondly, in many cases, and certainly- in the case of the recent Pan Am-United transaction, the alternative was greatly weakened U.S. flag competition on the routes in question and loss of competition over the rest of its system. The transfers

will put strong U.S. flag competition on those routes while providing needed capital to enable Pan Am to reorganize and continue as a competitive carrier.

This is not to say that in every case the sale and transfer of a route must be approved. If the sale would not assist the selling carrier to remain an active competitor, there might be legitimate concerns about trafficking in franchise rights. Under the Department's approach, such a liquidation type of transaction would be likely to be disapproved.

CONCLUSION

In conclusion, we are faced with a crisis such as the airline industry has never faced before. The economic environment, with war, recession, fear of terrorism, excessive fuel prices, etc., is quite simply disastrous for the air transportation business. The capital has been rapidly drained out of all but a few carriers. New capital, whether equity or loans, is not available from the U.S. financial sources, either private or the government. Unless the Congress is prepared to consider a guaranteed loan program to support the weaker carriers, the Congress at least must allow the continued sale of assets, including international route operations, and expand our opportunity to attract foreign investment.

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STATEMENT OF MARION KINDIG

During the Aviation Subcommittee hearing this morning, Mr. Samuel Skinner, Secretary of the Department of Transportation testified that Pan Am would be in Chapter 7 liquidation today if the London route transfer did not go through.

Not only is this statement false, but the DOT was made aware in a brief I filed with the DOT on January 24, 1991, that the Pension Benefit Guaranty Corporation had contacted three major financing institutions, each of which is recognized as a leader in providing DIP financing, and that these institutions expressed interest to the PBGC in providing DIP financing to Pan Am. However, Pan Am was so desperate for financing that it did not even bother to contact any of the three institutions.

In the PBGC Response filed January 10, 1991, in Pan Am's Chapter 11 proceeding, the PBGC further stated:

"The Debtor's contend that assumption of the UAL Agreement and the transfer to UAL of Airways' route authorities be-tween the United States and London Heathrow Airport pursuant to the UAL Agreement is 'essential to Debtors' ability to continue their current operations and reorganize in these cases.' However the PBGC objects to the Debtors' linking of DIP financing with the UAL Agreement to create an artificial emergency. Further, there is no showing before this Court that such a linkage is in the best interest of Debtors, their estates and their creditors.

"Debtors make no demonstration whatsoever in their Motion that the extraordinary authorization to sell the London Routes to UAL, without offering that opportunity to others in an open bidding procedure, is appropriate."

"As reported in a Wall Street Journal article on October 29, 1990, page B1, American Airlines proposed to offer Pan Am $200 million more for the London Routes than the cash price in the UAL Agreement, but was precluded from pursuing that transaction by the existence of the 'lock up' provisions of the UAL Agreement."

"Recent events point to a conclusion that the purchase price in the UAL Agreement is too low."

"In light of the foregoing, the PBGC respectfully requests that the Court order the Debtors to seek alternative DIP financing, not linked to the UAL Agreement, in order to provide all interested parties the opportunity to bid for the London routes."

Although this route transfer is categorized as "the London Routes", it actually includes considerably more than that. Attached as "Exhibit I" is a listing from the DOT's Final Order of February 6, 1991, of the actual routes to be transferred. It includes not only Pan Am's East Coast, West Coast and Chicago flights to London, but the authority to Western European Countries, Eastern European Countries, Russia, the Middle Eastern Countries, Pakistan and India and around the world - all for the firesale price of $290 million". It is little wonder that a sham emergency was created, and that United would prefer to rush this transaction through before anyone has the opportunity to get a good look at what is occurring.

Not only was there a bid of $200 million more for these routes from American Airlines, but there were higher bids from Delta, TWA and Tra-Cinda Corporation (which wanted to also offer Pan Am an immediate cash infusion of $150 million and take over all of Pan Am.)

THE $840 MILLION FRAUD UPON THE PUBLIC

When Pan Am declared Chapter 11 on January 8, 1991, it left a legacy of $840 million in plundered employee pension plan liabilities to its employees, its beneficiaries, the PBGC, the consumer and ultimately the hapless taxpayer. The more that is obtained for Pan Am's routes, the less will be the ultimate burden upon the public. Consequently, it is definitely in the public interest to obtain the maximum possible for Pan Am's routes. The DOT was made aware of this in briefs I filed with the DOT on January 2, 18 and 24, 1991. Section 401(h) (l) provides that a certificate may only be

transferred if it is determined to be in the public interest. This transaction is very definitely contrary to the public interest.

In spite of the fact that the DOT was made aware of all of the above in briefs I filed with the DOT and by excerpts from the PBGC's brief filed in the Pan Am bankruptcy on January 10, 1991, the DOT refused to hold an oral evidentiary hearing. Additionally, the DOT was made aware of the myriad of false statements and misleading statements that were contained in the Joint Answer submitted by United and Pan Am on January 22, 1991. Attached as Exhibit 2 is a copy of my January 24, 1991, brief with extensive documents. Also attached as Exhibit 3 is a copy of the PBGC's brief filed on January 10, 1991.

Not only was the aforementioned not addressed in the DOT's Final Order, but that Order itself was replete with misstatements and false statements, as more fully outlined in the letter to Mr. Samuel of February 18, 1991—attached as Exhibit 4.[1]

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*February 27, 1991.*

HONORABLE WENDELL H. FORD,

*Chairman, Subcommittee on Aviation, Senate Committee on Commerce, Science & Transportation, Washington, D.C.*

Dear Senator Ford:

Aloha Airlines would like to respond to Mr. Clyde McAvoy's letter of February 20 which is critical of Hawaiian Airlines' recent testimony presented to your Subcommittee. Mr. McAvoy protests several Hawaiian statements, including the statement that Japanese interests continue to control, if not own, Discovery Airways. Aloha would like to associate itself with Hawaiian's statement insofar as the continuing ownership and control of Discovery by Japanese interests is concerned. Aloha would also request that you treat this letter as an addendum to Aloha's previously submitted written testimony.

The continuing saga of Discovery Airways is one of the more remarkable chapters in recent aviation history. Although Discovery has not operated since July 13, 1990, more than seven months ago; Aloha understands that Discovery continues to make lease payments on no fewer than five aircraft and pay the salaries of more than 140 employees. These not inconsiderable expenses approximate $2 million each month. Aloha understands that this more than $14 million expense has been entirely funded by Japanese interests.

While Mr. McAvoy, in strikingly similar terms to his predecessors, represents that Discovery's voting stock is U.S. owned and that Discovery is U.S. controlled, Aloha would respectfully suggest that the limited information known to Aloha indicates otherwise. So far as Aloha knows, even though the names on the Discovery voting share certificates may have been changed, the original owner of that stock, the Nansay/Philip Ho interests, has yet to receive payment for its stock. If that is so, one could rightfully question whether the U.S. citizens who may nominally be the owners of the voting stock are indeed the real parties in interest.

Mr. McAvoy also conveniently neglects to address the nationality of the holders of Discovery's non-voting equity, as well as debt securities. It should be recalled that almost 90 percent of Discovery's previous capital structure consisted of subordinated debentures which Discovery, as well as the Department, has labeled as debt. Ultimately, it turned out that the total U.S. investment in Discovery was no more than $150. Aloha would be highly skeptical that anything of substance has changed in this regard. To underscore this fact, Aloha understands that Discovery has been receiving its weekly funding in the form of cash and travelers checks brought by couriers from Japan. One can only surmise the reason why these funds are being transferred in what would appear to be such an unconventional manner.

Whatever one may conclude about the present ownership of Discovery's voting stock, the overriding fact remains that all of Discovery's funds continue to flow from Japan. Therefore, unless one is inclined to deny reality, as Mr. McAvoy would apparently have the Subcommittee do, it can only be reasonably concluded that the Japanese individuals, who are the sole source of Discovery's funds, do in fact control Discovery's most basic business decisions—whether Discovery remains in operational readiness or whether Discovery actually shuts down.

Mr. McAvoy should also appreciate that no one has ever suggested that the Department's recent liberalization of its de facto control doctrine in the Northwest/KLM case would extend to similar control emanating from Japan. Secretary Skinner testified before your Subcommittee that a prerequisite for allowing such liberalized control by foreign investors would be the existence of a liberal entry aviation bilateral agreement and a climate receptive to reciprocal U.S. investment. Japan, to the contrary, represents the very antithesis of open entry and a welcome climate for U.S. investors.

To the extent that Discovery believes that any of Aloha's conclusions are incorrect, Aloha would welcome an objective and thorough examination of the facts. Indeed, Aloha would encourage Discovery to initiate that process sooner, rather than later, to avoid any "manufactured" emergencies in which a decision by the Department of Transportation is suddenly demanded on short notice.

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[1] The exhibits were not reproducible.

Once again, Aloha appreciates the opportunity to respond to Mr. McAvoy's letter.
Sincerely,

A. MAURICE MYERS, *President & Chief Executive Officer.*

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DISCOVERY AIRWAYS,
*February 20, 1991.*

HON. WENDELL H. FORD,
*Chairman, Senate Subcommittee on Aviation, U.S. Senate Washington, DC.*
Dear Mr. Chairman:

Testimony before you on February 19, 1991, by J. Thomas Talbot, Chairman of Hawaiian Airlines, in his effort to persuade you on a course of action, takes liberty with the facts. Specifically:

Discovery Airways is not foreign-owned and controlled. It is in fact structured with less foreign ownership than Mr. Talbot's own airline. In truth, there is zero foreign ownership of Discovery's voting stock and there is zero foreign influence or control exercised in any other channel.

Although I am one of three partners "now repackaging" the new Discovery, I played no role in the formation of the old Discovery beyond introducing its founder to its investor at a one-time meeting. I neither participated in the structuring of the old Discovery, nor was I aware of its details until they were announced publicly. I did not consult, advise, invest, profit from, or in any other way become involved with the old Discovery.

Recent events show that Hawaiian's financial straits are of its own making, and were not caused by either the old or new Discovery. An attempt to blame Hawaiian's woes on an airline which has yet to carry a single paying passenger on routes operated by Hawaiian is professionally indefensible. To the press, Mr. Talbot has attributed his airline's poor performance to a lack of knowledge of Hawaiian's financial circumstances before he purchased it. In other words, he neglected to do his due diligence research.

It is clear that no combination of owners-investors in the new Discovery will find favor with a competitor like Mr. Talbot. He does a disservice to the Subcommittee with his testimony.

Sincerely,

CLYDE McAVOY, *President.*

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